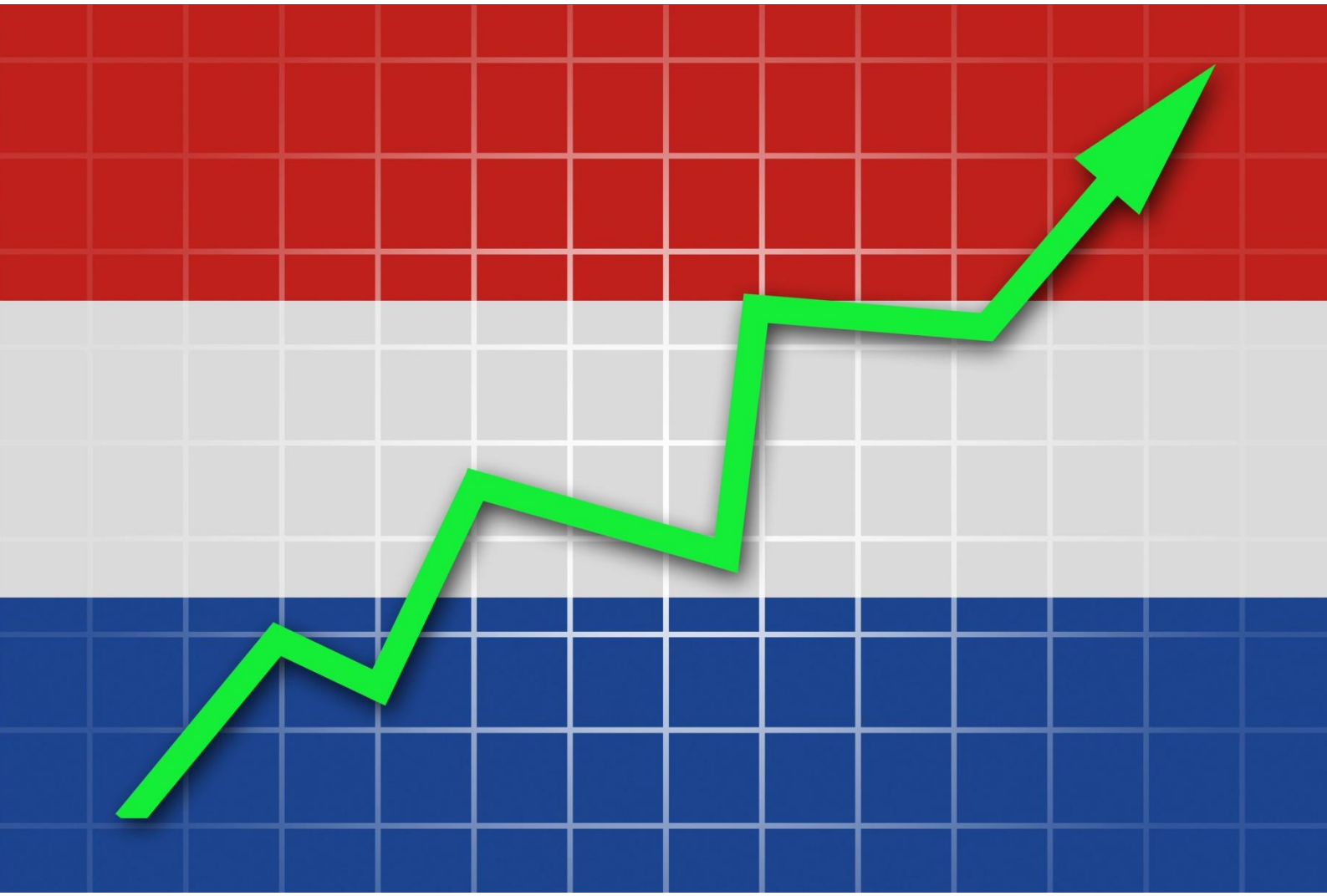
NExit

6 February 2014

CAPITAL ECONOMICS

Assessing the economic impact of the Netherlands leaving the European Union



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NExit

Assessing the economic impact of the Netherlands leaving the European Union

A report by Capital Economics for Partij voor de Vrijheid

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KEY FINDINGS

Capital Economics has been commissioned by *Partij voor de Vrijheid* to research and report upon the likely economic impacts of the Netherlands exiting the European Union, 'NExit'.

Inside the European Union, the Netherlands is destined for rates of economic growth not only lower than those that are commonplace on every other continent of the world, but also lower than achieved domestically in recent decades. But outside the European Union, Dutch authorities could:

- reduce the costs of doing business in the Netherlands by a minimum of €20 billion annually by 2035 through 'renationalising' regulations in areas currently in the jurisdiction of Brussels institutions

- improve public finances by opting out of European Union spending programmes, which should add a cumulative €240 billion to gross domestic product by 2035

- reduce public expenditure by a minimum of €7.5 billion annually (by 2035) through revising immigration policy to focus more tightly on admitting only those who make an economic contribution

- grow exports to non-European markets faster by negotiating and trading with high growth emerging economies without being tied to a common trade policy

- manage cycles in the macroeconomy more effectively by having the freedom to set monetary and fiscal policy to fit Dutch national conditions, and not the euro-zone as a whole. Netherlands-focussed policies may help address the current economic crisis, and should see the economy accumulate €309 billion extra national income by 2035

There are economic costs to leaving the European Union, particularly in relation to replacing the single currency with a national one. But these costs are modest and manageable. Moreover, fears that introducing a new guilder may prompt a structural revaluation of the Dutch currency against the euro (and other currencies) are, we believe, unfounded. We find little evidence to suggest that, beyond initial and temporary market volatility, the new guilder will either appreciate or depreciate substantially. As such, NExit is no threat to banking stability, or to the Netherlands' sovereign debt or pensions positions.

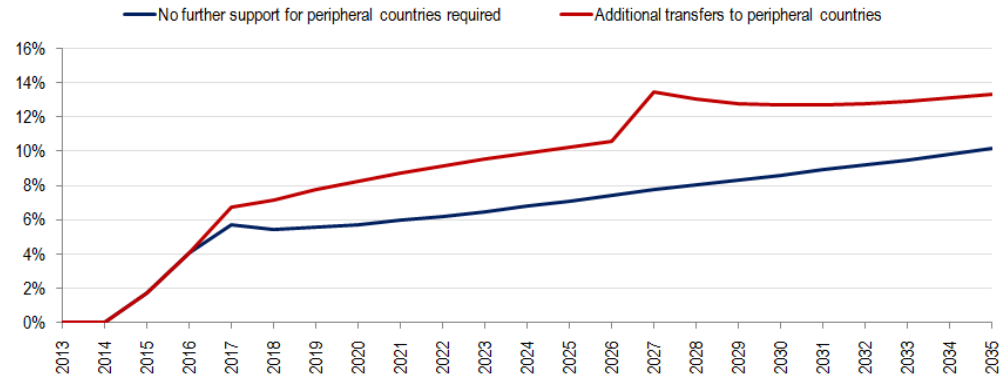
Overall, the various strands of analysis point to NExit being a long-term benefit to the Dutch economy and, more than likely, a short-term help in easing the Netherlands out of its current economic ills.

For a NExit which is assumed to be announced on 1 January 2015, a Swiss-like relationship between the Netherlands and the European Union should see Dutch gross domestic product somewhere between 10 and 13 per cent higher by 2035 than it would have been had the Netherlands continued as a member of the Brussels-led bloc. (See below.) Over that 21 year period, the benefits of NExit to Dutch national income would have accumulated to between €1,100 billion and €1,500 billion in today's prices. (See

below.) This is equivalent to between €7,100 and €9,800 per household each year. But even if the Netherlands is unable to negotiate a status akin to Switzerland's, the economy would be better off out of the union than in. Although there are margins of error associated with any research of this nature, we have stress tested our other key assumptions, and find our broad conclusions robust.

There are, of course, risks to leaving the union – and these need to be recognised and addressed by anyone considering NExit. But there are also significant risks to staying in a bloc with a fundamentally flawed currency and the threat that transfers to debt-laden peripheral states will spiral out of control. In this instance, our analysis shows that the Netherlands would be better off taking control of its own destiny, rather than sticking with the 'devil it knows'.

Impact of 'NExit' on national economic performance versus what would happen if the Netherlands remained in the European Union (Positive values represent 'NExit' as an improvement over continued membership)



Source: Capital Economics. See Chapters 14 and 15 for details of the calculations.
Notes: (i) Measure of national economic performance is annual real gross domestic product. (ii) Assumes NExit on 1 January 2015 and a negotiated Swiss-style future trading arrangement between the Netherlands and the European Union. (iii) Two lines represent two possible outcomes for the Dutch economy of remaining within the bloc depending on the extent of future bailouts of indebted and distressed members of the euro-zone.

Cumulative gross domestic product impact of individual elements of 'NExit' by 2035, € billions (2013 prices)

	'EFTA + bilaterals' with 'No further periphery support'	'EFTA + bilaterals' with 'Periphery supported fully'
Transition and ongoing currency transaction costs	-52	-52
Public finances	240	240
Macroeconomic policies	309	309
Immigration	163	163
Regulation	326	326
Trade	66	66
Inward investment	69	69
Bailouts of peripheral and other distressed euro-zone economies	-	426
Total	**1,121**	**1,547**

Source: Capital Economics. See Chapters 14 and 15 for details of the scenarios and calculations.

CONTENTS

1 INTRODUCTION AND SUMMARY

Capital Economics has been commissioned by *Partij voor de Vrijheid* to research and report upon the likely economic impacts of the Netherlands exiting the European Union, 'NExit'.

1.1 The economic rationale for NExit

Any decision to leave the European Union is first and foremost a social, cultural and political one. It must revolve around issues of national sovereignty, citizenship and freedom of determination. However, there are also good reasons to believe that a nation, untied from the bureaucracy of Brussels and able to make decisions for itself rather than have imposed one-size-fits-all policies, will benefit economically too.

First, exiting the European Union is, without doubt, a substantial step for any member state to make. But, equally, any decision (or, more likely, indecision) to stay within the bloc is no less significant – nor is it any less likely to result in future change. The Europe of tomorrow will not be the Europe of today, regardless of whether the Netherlands remains part of the union.

Indeed, looking ahead, membership of the European Union will provide no economic panacea for the Netherlands – even if there are no further crises in the peripheral euro-zone countries (which we think is unlikely). In the near term, the economy will be one of the slowest in northern Europe to recover from the recessions following the 2008/9 credit crunch. Thereafter, rates of growth appear set not only to be much lower than those in Asia, Africa and America, but also of key European competitors, including those outside the euro-zone and the European Union. Moreover, even after the current problems are distant history, the Netherlands' rate of economic growth looks set to underperform its historic averages. The exact numbers in our own forecasts are more pessimistic than those of some other commentators. But all paint a similar picture.

What's more, there are further significant downside risks to this less-than-rosy prognosis. Although the euro-zone crisis appears to have abated, the structural problems that underlie the currency union remain. To avoid the economic costs of painful internal devaluations, either further substantial bailouts of indebted peripheral nations will be required or the euro must break-up, or both. (See Chapter 2: Outlook from within the European Union.)

Second, with NExit, Dutch authorities can extricate themselves from their current commitment to part fund European Union programmes and policies,

and use the money instead to pay for domestic policies, reduce taxes, pay-down government debt or a combination of all three.

Reducing or removing direct payments to Brussels should improve Dutch public finances by up to €2.9 billion in 2017, rising to €4.7 billion annually by 2035 (in today's prices), depending on what arrangements are agreed for relations after NExit. Further savings could well be achieved by reviewing and reducing public spending (such as that under the common agricultural policy) currently conducted in the Netherlands under the auspices of the European Union but effectively funded by Dutch taxpayers, which amounts to 0.35 per cent of national income. (See Chapter 3: Public finances.)

Third, burdensome and prescriptive regulations imposed by Brussels are another substantial cost of European Union membership to Dutch businesses. After NExit, the Netherlands could free itself of much of this burden and employ a more targeted and less onerous regulatory framework – although continued membership of the internal market, if desired, will be dependent on adhering to certain related legislation in areas such as product standards and competition policy.

Quantifying the potential gains is not straightforward; the majority of the empirical analysis on the cost of such regulations focuses on broad estimates of the gross costs and does not consider any potential benefits. But a thorough study in the United Kingdom finds that domestic legislation is nearly 2½ times more efficient than that of the European Union, and there is no reason to think that this is any different in the Netherlands. (See Chapter 4: Regulation.)

Fourth, with NExit, the Netherlands can make its own decisions about the appropriate scale and nature of immigration, and better tune its border policies to meet its economic interests.

The European Union influences the way in which Dutch authorities can develop and implement immigration policy not only for citizens of other member states but also for those from beyond the union.

For example, simply stopping 'non-western' immigration for the purposes of family re-unification and asylum (which is required under the union's family reunification and qualification directives) would initially save Dutch taxpayers €4.0 billion for each annual wave of immigration excluded (in present value terms) through reduced pension, education, welfare and health costs across their lifetimes, and this will rise with migration trends. Importantly, this is even after taking account of the taxes that would be paid by those migrants. (See Chapter 5: Immigration.)

Fifth, the global economic order has changed markedly and forever. Future growth will come predominantly from the emerging markets of Asia, South America and, eventually, Africa. The challenge for the Netherlands, and for other European economies, is to realign trading patterns to take full advantage.

The European Union as a whole has a poor record on this front. Outside the bloc, Dutch authorities have the opportunity to capitalise more fully on their country's international entrepreneurialism and tap into foreign growth currently eluding many Europeans.

Of course, the rest of the union will remain a vital trading partner for the Dutch; over 70 per cent of Dutch exports are destined for other member states. So, it would be foolish to damage Dutch businesses' prospects in European markets. But NExit wouldn't do this. Given the level of trade inter-dependency between the Netherlands and other, especially northern, member states, and particularly the role of the Port of Rotterdam and Amsterdam Schipol airport as trade hubs, there is as much interest for, say, Germany in maintaining good trading relations with the Netherlands as *vice versa*.

It is completely possible (indeed, likely) that the Netherlands could negotiate a Swiss or Norwegian style arrangement with the European Union whereby it retains the benefits of the single market, but is free to negotiate at will with countries beyond. This would be the best of both worlds. But even if this is not possible and, for whatever petty reasons, there is no negotiated exit and the Dutch become subject to the full force of European external tariffs, our calculations suggest that the impact on trade will not be that large and over time will still deliver economic benefits. (See Chapter 6: Globalisation.)

And sixth, outside of the European Union, the Dutch government and central bank can regain control over monetary, financial and fiscal policy, and set interest rates, taxes and public spending to address the specific needs of their stalling national economy. This will have near term benefits during the current economic crisis, and longer-term value as policy develops around the business cycle in the Netherlands and not in Germany.

The years since the inception of the euro have been disappointing for the Dutch economy. Consumption has slumped, households are highly leveraged and, although there are some signs of modest recovery, its progress is slow even against the tortoise-like performance of other member states.

This is not surprising. The Dutch malady is being treated using the prescription for a German patient. But there are significant differences between the two economies. The biggest challenge for the authorities is to encourage Dutch consumers to start spending. Household consumption in the Netherlands has been weak for the past decade, and has collapsed since the

onset of the financial crisis in 2008. This hasn't happened in Germany. So unlike Germany (or at least what German authorities believe would be best for Germany), the Netherlands would benefit from looser monetary conditions (maybe a lower base rate, some quantitative easing, slightly looser balance sheet requirements on banks, or a combination of some or all) while austerity measures are weakening domestic demand at the very time that Dutch businesses and consumers need to be spending. These issues can be better addressed with NExit and the macroeconomic policy freedoms it brings. (See Chapter 7: Macroeconomic policy.)

1.2 Risks and concerns

The unravelling of 61 years of Dutch membership of the European Union and its predecessors (the European Coal and Steel Community, European Economic Community and European Community) would be no small task, and it justifiably causes concern and has its own associated risks. But many of the concerns surrounding NExit can be addressed, while it is all too easy to overstate the risks.

First, although there will be some costs of the transition itself, especially in replacing the euro, a smooth NExit is legally, politically and practically feasible. (See Chapter 8: Transition.)

Second, the introduction of a national currency would allow international exchange markets to revalue the new guilder against the euro, with potential consequences (both positive and negative) for the macroeconomy.

Initially, investors and currency speculators may see the Netherlands as a safe haven from the systemic dangers of an indebted and unbalanced euro-zone, which would cause the new currency to appreciate. Or they would see NExit as a risky venture into dangerous uncharted waters, and devalue it. It is simply impossible to judge in advance how markets will react in the immediate period after NExit becomes public knowledge, but previous examples of countries leaving currency unions suggest that any period of volatility is short-lived (typically around six months).

But beyond the initial unpredictability, there is little to suggest any significant revaluation against the euro is needed in the medium term. The Netherlands is neither Greece nor Germany so we shouldn't expect the new guilder to be a *drachma* or a *deutsche mark*. The Netherlands shares some of the economic characteristics of Germany, especially its trade surplus, and some of those of the peripheral states, with high household indebtedness and weakening competitiveness. There are equally good arguments to suggest that depreciation is likely as appreciation; neither can be ruled out. But overall, our

analysis shows that there is unlikely to be a substantial structural revaluation of the new guilder either way.

In the longer-term, if we are right and the Netherlands' economy is better off out of the European Union, the new guilder should gently appreciate against the euro as a result of higher growth and greater investor interest. (See Chapter 9: Currency.)

Third, although we believe that NExit will enhance prospects for the Dutch economy, we cannot presume that others, like the credit ratings agencies, will think the same. Indeed, withdrawal from the European Union may bring with it a further downgrade to the Netherlands' debt ratings.

But a downgrade isn't something to be feared greatly. It is unlikely to have a significant, if any, impact on borrowing rates. And even if it does, a large share of the Dutch government debt servicing is protected from interest rate increases in the short term as the average residual maturity is seven years. There may be a knock-on impact on ratings and rates in the Dutch corporate bond market – but, even here, it is likely to be limited. (See Chapter 10: Sovereign debt.)

Fourth, there is the potential for NExit to cause short term instability in the banking sector but, if it does, the impact is likely to be modest and short-lived.

Deposits in banks are covered by guarantees and the central bank would be in a position to provide short term funding to banks experiencing a severe crisis. Meanwhile, imbalances on the euro-zone's cross-border bank clearing system, TARGET2, can be resolved if *De Nederlandsche Bank* converts its claims into foreign exchange held at the European Central Bank. (See Chapter 11: Banking stability.)

Fifth, the Dutch hold substantial wealth in the form of pension funds. By and large, the only significant way in which NExit might impact on these will be through any currency revaluation brought about by departure from the euro.

In the short term, any initial currency volatility should have no material impact on structures that are funded and regulated for much longer time horizons. However, any structural appreciation of the new guilder, which we believe is unlikely, would worsen pension funds' funding ratios while any depreciation will bring improvement. (See Chapter 12: Pensions.)

And sixth, the Netherlands is among the European Union's top destinations for foreign investment, both for redirection elsewhere and for domestic development. Although NExit may influence some investors, Dutch attractiveness is mostly independent of the European Union and may even increase.

Inward investment plays an important role in the Dutch economy. Firms choose the Netherlands for its location in Europe, its flexible and educated labour force, good infrastructure and its existing business clusters, all characteristics which will be unchanged by NExit. Although exit will impact on foreign firms investing to export to the rest of the European Union, these problems should be minimal if the Netherlands negotiates continued access to the internal market. What's more, with appropriate external trade and investment agreements, the Netherlands could become a more attractive place to invest and NExit could bring tangible increases in gross domestic product. (See Chapter 13: Inward investment.)

1.3 The prospects after NExit

The economic and policy freedoms that an exit from the European Union will give Dutch policymakers, especially in the longer term, provide an opportunity for the Netherlands to see rates of growth in prosperity that have looked otherwise consigned to distant history. Indeed, a NExit may even offer a more immediate fillip to an economy currently in crisis as monetary policy levers can be pulled in Amsterdam, rather than Frankfurt, and Brussels-inspired fiscal austerity can be recalibrated to Dutch and not German needs.

In this report, we make estimates of the scale of the various potential benefits (and costs) of NExit for the Dutch economy. But, while economics is, of course, far from an exact science, predictions of these types are used to show the broad scale and direction of impacts, and the specific estimates presented herein should be viewed in this context. But, throughout, we have taken what we believe to be a realistic but cautious approach. (See Chapter 14: Assessing the impacts.)

When adding the impacts of the various elements of NExit together we can comfortably conclude that a well-executed NExit should deliver sustained higher rates of growth in Dutch gross domestic product than remaining within the bloc, and that these benefits are significant.

For a NExit which is assumed to be announced on 1 January 2015, a Swiss-type trading arrangement between the Netherlands and the European Union should see Dutch gross domestic product somewhere between ten and thirteen per cent higher by 2035 than it would have been had the Netherlands continued as a member of the Brussels-led bloc. (See Figure 1.) Over that 21 year period, the benefits of NExit to Dutch national income would have accumulated to between €1,100 billion and €1,500 billion in today's prices. (See Figure 2.)

The profile of the overall benefit changes over time, with the fiscal and monetary stimulus adding most to growth in the short term and European Union budget savings and improvements to the business environment adding the most in the long term. Meanwhile, we have stress tested our key assumptions, and find our broad conclusions robust.

Figure 1: Impact of 'NExit' on national economic performance versus what would happen if the Netherlands remained in the European Union (Positive values represent 'NExit' as an improvement over continued membership)

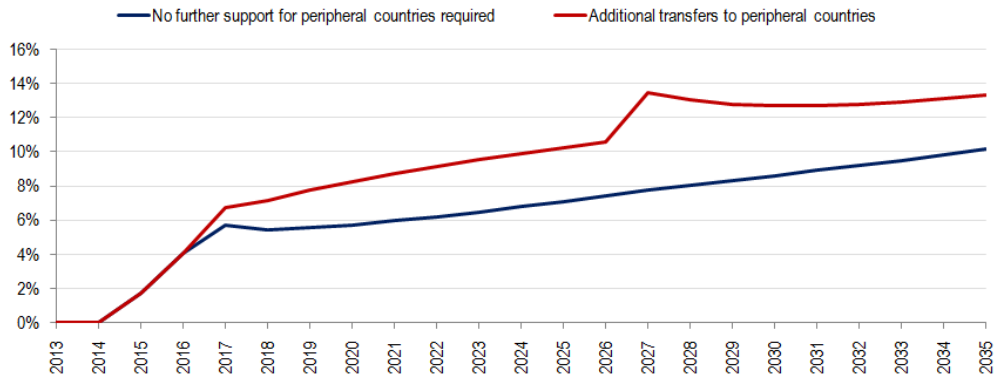


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Figure 2: Cumulative gross domestic product impact of individual elements of 'NExit' by 2035, € billions (2013 prices)

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Total	**1,121**	**1,547**

Source: Capital Economics. See Chapters 14 and 15 for details of the scenarios and calculations.

PART I: THE ECONOMIC RATIONALE FOR NEXIT

Part I considers the economic rationale for NExit.

Any decision to leave the European Union is first and foremost a social, cultural and political one. It must revolve around issues of national sovereignty, citizenship and freedom of determination. However, there are also good reasons to believe that a nation, untied from the bureaucracy of Brussels and able to make decisions for itself rather than have imposed one-size-fits-all policies, will benefit economically too.

We examine six reasons why the Netherlands may be better off economically outside the European Union than in it:

- ***The outlook from within the European Union.*** **Membership of the European Union offers no economic panacea. The prospects for the Netherlands are far from rosy, with it (and much of the rest of the bloc) destined for future growth well below other regions of the globe and below rates achieved in their recent history**

- ***Public finances.*** **Outside the European Union, the Netherlands will no longer be committed to raising taxes to fund Brussels-determined programmes of public expenditure in other countries, and Dutch authorities can make their own decision as to whether European programmes conducted locally are worth continuing**

- ***Regulation.*** **After NExit, Dutch policy-makers can determine the nature, scale and cost of business regulations, and reduce one of the most often cited burdens of doing business in Europe**

- ***Immigration.*** **Dutch authorities can regain full control of national borders on withdrawal from the European Union, and immigration policy can be better formulated to reduce the burden on taxpayers**

- ***Globalisation.*** **With European Union exports failing to keep up with growth in the emerging economic superpowers of Asia and other developing countries, Dutch trade prospects may be improved by negotiating directly with these countries from outside of the European Union**

- ***Macroeconomic policy.*** **After NExit, monetary and fiscal policy can be set to reflect the needs and requirements of the Dutch economy, and not the euro-zone as a whole**

2 OUTLOOK FROM WITHIN THE EUROPEAN UNION

In this chapter, we consider the economic outlook for the Netherlands, if it remains as a member the European Union.

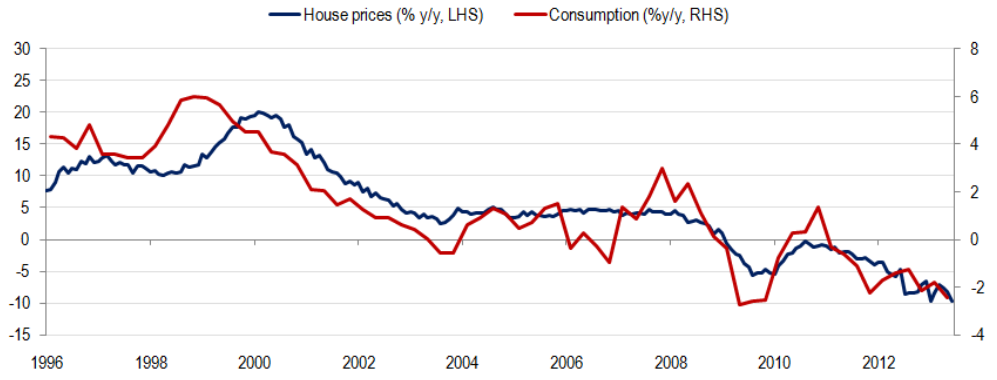
In doing so, we develop what scientists might call their 'control', if they were conducting an experiment, or what economists call the 'counter-factual'. It is the base case, or what would happen otherwise, against which we can later measure the impact of an exit.

Indeed, it is important when evaluating policy options to avoid comparing what might be the case in the future against what it is now; instead, any comparison should be between the future outcomes offered by the different policies. The Netherlands and the Europe of tomorrow will not be the Netherlands and the Europe of today, regardless of whether the Netherlands remains part of the union.

Our starting point for developing the base case is today's economic situation.

Although a founding member of the original coal and steel community in 1951 and always perceived to be tightly linked economically to Germany and the other BENELUX countries, it would be a mistake to generalise that the Netherlands and these other 'core euro-zone' economies are all the same. There is a marked difference between their current circumstances.

Figure 3: Annual percentage change in house prices and consumption

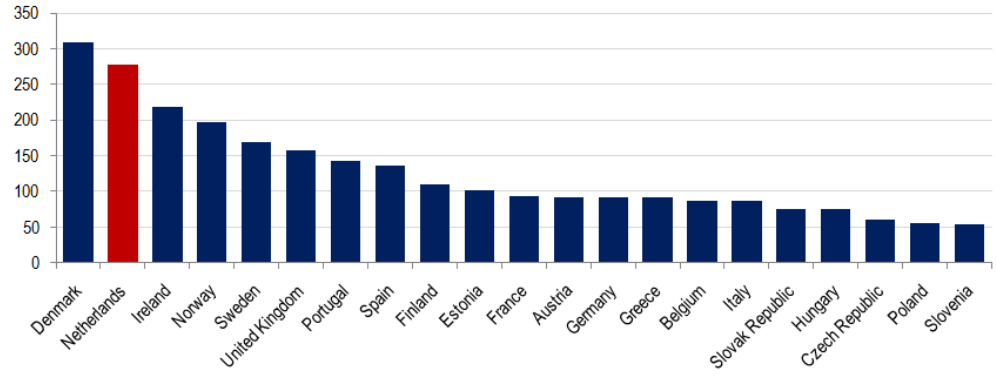


Source: Thomson Datastream

The Netherlands is gripped by weak domestic demand, especially falling real consumer spending, resulting partly from a recent history of residential property boom and bust. (See Figure 3.)

Dutch households are now among the most indebted in Europe, with a ratio of debt to national income two-to-three times that seen in other 'core' countries like Germany. (See Figure 4.) The 'net debt' position is somewhat different, as households in the Netherlands do have large savings in the form of pensions and property. However, given the illiquid nature of the asset side of households' balance sheets, the gross position is more relevant when considering the ability of households to manage their finances in the short to medium term.

Figure 4: Gross debt of households and non-profit institutions serving households, as a percentage of gross disposable income, 2010

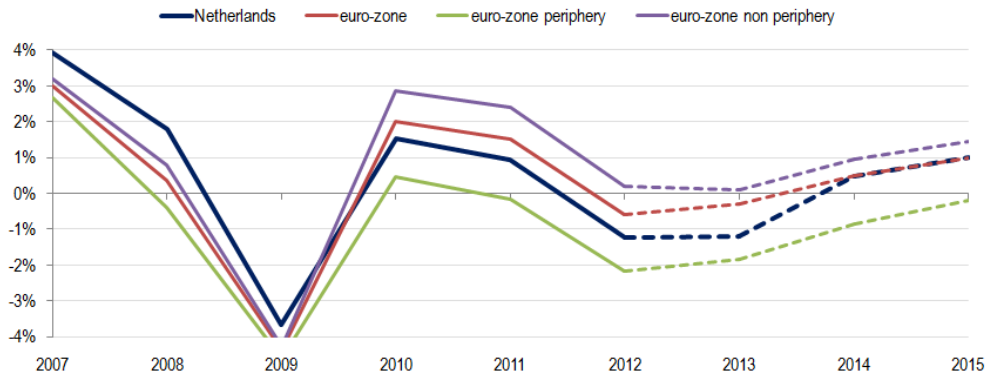


Source: Organisation for Economic Co-operation and Development

Even assuming there are no further repercussions from the euro-zone, banking or global crises (which is, to say the least, far from guaranteed), the Dutch economy is only likely to recover from its current malaise slowly. Our own forecasts for the near term show Dutch growth rates recovering the euro-zone average in 2014 or 2015, but remaining below what's typical for the 'core' countries.[1] (See Figure 5.)

[1] Jonathan Loynes *et al*, *European Economic Outlook Q4 2013* (Capital Economics, London), 2013.

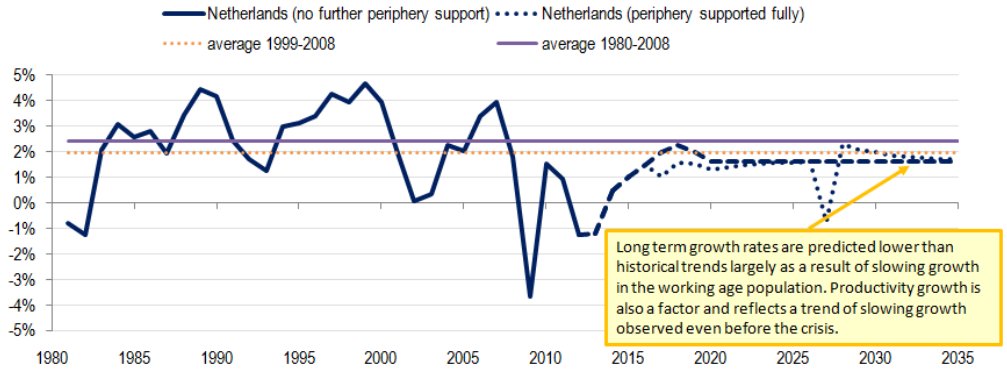
Figure 5: Capital Economics' forecast for annual percentage change in real gross domestic product



Source: Eurostat and Capital Economics

Looking further ahead, the Netherlands will find it difficult to achieve again average rates of growth as high as those experienced in the decades running up to the 2008 global financial crisis. Even if Dutch taxpayers provide no further support to the heavily indebted peripheral euro-zone countries, demographic trends mean that long term real economic growth is projected to be around only 1½ per cent annually. (See Figure 6.)

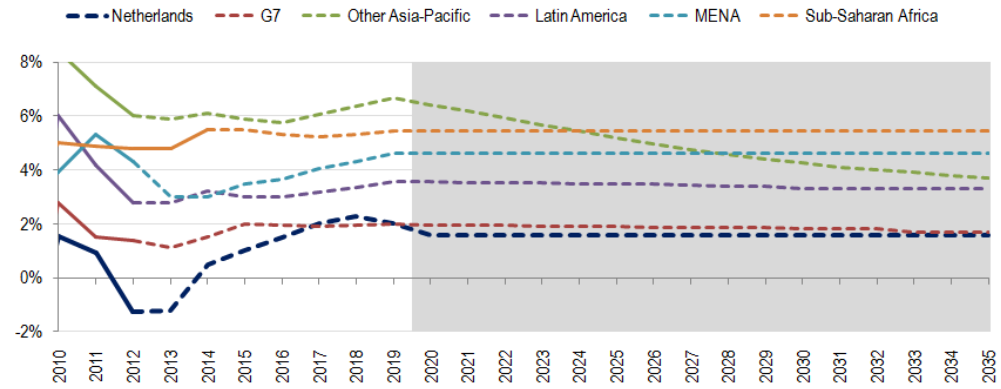
Figure 6: Capital Economics' 'no new crisis' forecasts for annual percentage change in real gross domestic product



Source: Eurostat and Capital Economics

Although Dutch projected longer-term performance is close to par for its neighbours in the euro-zone, it is weak in the context of growth in the emerging regions beyond Europe. (See Figure 7.)

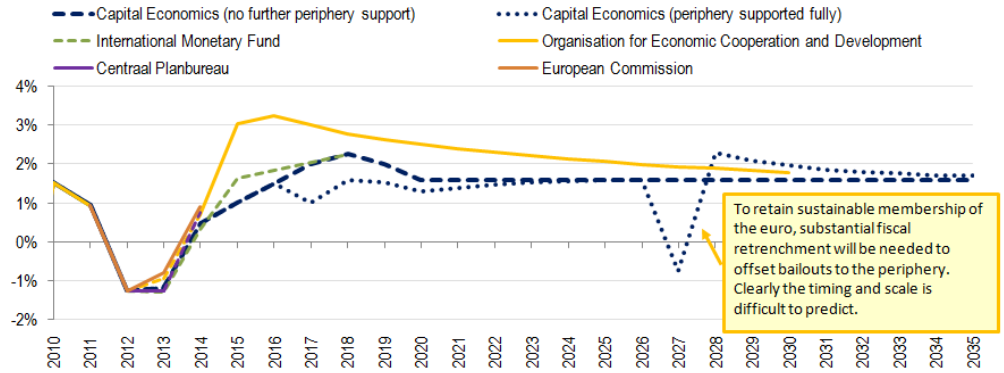
Figure 7: Capital Economics' forecast for annual percentage change in real gross domestic product



Source: Eurostat, Organisation of Economic Co-operation and Development, and Capital Economics

Of course, forecasting is not an exact science, and different forecasters make different predictions. But, with the exception of the relatively optimistic near-term projections from the Organisation for Economic Co-operation and Development, our forecasts are broadly similar to those from other reputable organisations. As such, although we do not claim that ours are necessarily superior to the others, it is reasonable to use our forecasts as the base line for subsequent analysis. (See Figure 8.)

Figure 8: Comparison of forecasts for annual percentage change in Dutch real gross domestic product



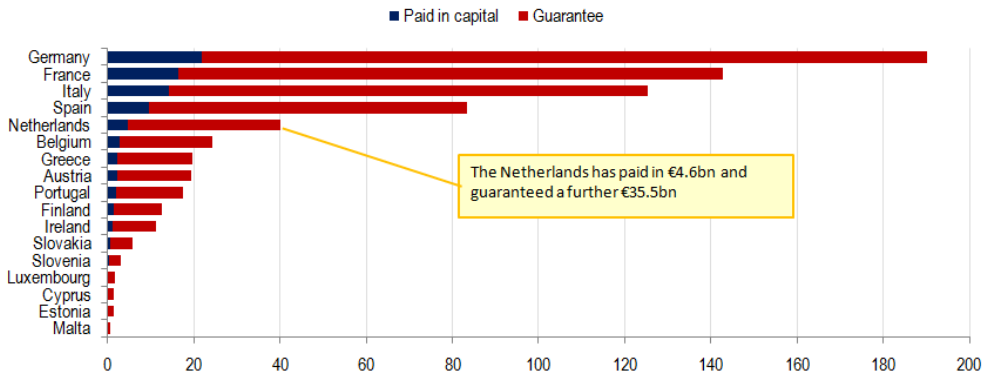
Source: Eurostat, Organisation for Economic Co-operation and Development (November 2012), International Monetary Fund (October 2013), European Commission (May 2013), *Centraal Planbureau* (August 2013) and Capital Economics

We have constructed two 'staying in the European Union' forecasts. These baseline scenarios reflect uncertainty over future transfers from core euro members to indebted peripheral nations. (See Figure 6.)

Our 'no further periphery support' scenario assumes that the Dutch do not need to do more than honour their existing commitment to the European stability mechanism. (See Figure 9.) This is not necessarily a direct drain on

taxpayers or current economics resources as it is a guarantee which European authorities can use to borrow from the market. It will only be a cost if a country defaults on its associated debt. Indeed, contributors like the Netherlands could potentially benefit if borrowing rates are low enough.

Figure 9: Capital subscription to the European stability mechanism, € billions



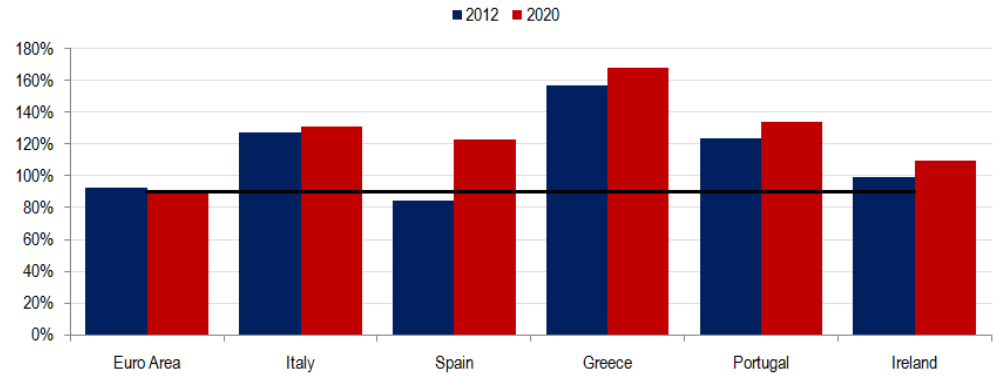
Source: European stability mechanism

Our 'periphery supported fully' scenario (which we believe is the more likely of the two) considers what might happen if the core euro-zone countries, like the Netherlands, are expected to further support the peripheral nations in order to bring their public debt levels down to more manageable levels.

Although their scale and timing are unpredictable, further bailouts are likely given the magnitude of public sector debt in many Mediterranean countries. Most inflicted countries are struggling, even with tough austerity measures in place, to control their annual budget deficits, let alone reduce their backlog of outstanding debts. As members of the euro, they are further hamstrung by the inability to reduce their debt burden through currency devaluation. Their continued indebtedness is to the detriment of their growth. The much cited and debated paper by Harvard academics Carmen Reinhart and Kenneth Rogoff suggests that economic growth drops sharply in countries with government debt levels of 90 per cent of national income and above.[2] (Coincidentally, 90 per cent is approximately the average debt ratio currently across the whole of the euro-zone.) What's more, lower growth makes the debt more unsustainable, and crises, defaults and/or bailouts more likely. (See Figure 10.)

[2] Carmen Reinhart and Kenneth Rogoff, 'Growth in a Time of Debt', *American Economic Review: Papers & Proceedings*, Vol. 100, No.2, 2010. pp 573–578

Figure 10: Projected gross government debt as a share of gross domestic product

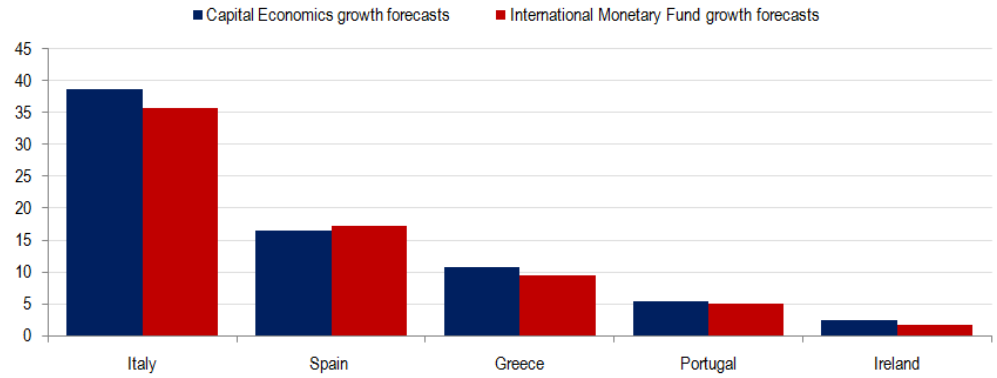


Source: Capital Economics' analysis of Eurostat and International Monetary Fund data.

But further bailouts are likely given the scale of unsustainable public sector debt in the peripheral countries.

Currently, the average debt to gross domestic product ratio of all euro-zone economies is 90 per cent, which in itself is 30 percentage points above the Maastricht treaty targets, while the peripheral states' debt levels are considerably higher.

Figure 11: Netherlands' potential fiscal transfers to periphery, € billions



Source: Capital Economics' analysis of Eurostat and International Monetary Fund data. Note: Dutch share based on share of contributions to European stability mechanism.

Our scenario is based on reducing government debt levels in peripheral countries to 90 per cent of gross domestic product through transfers from core countries. We calculate that the Netherlands' proportionate share of this bailout would be in the order of €74 billion in current prices. (See Figure 11.) This is a relatively conservative estimate. There are other plausible bailout scenarios, published by us and others, that suggest more than this could be required. (See Figure 12.) Moreover, any peripheral government debt crisis is likely to either precipitate or to have been precipitated by distress in those countries' corporate, household and/or financial sectors. These may also

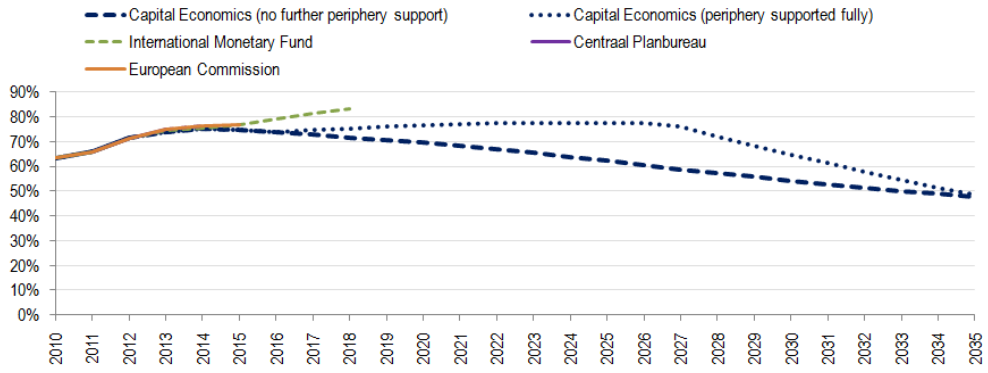
require bailing out, and the scale of such transfers could easily match those needed to support the public sector. We have conservatively assumed that this adds a further 50 per cent to the cost to the Netherlands.

Figure 12: Alternative estimates of the potential for further fiscal transfers to peripheral nations, 2013 prices

	Summary of method	Estimated total public finance cost to the Netherlands
Lombard Street Research	Greece and Portugal have debts written off entirely. Italy and Spain have deficits funded	€118 billion
Lombard Street Research	Greece and Portugal have debts written off entirely. Italy and Spain have deficits funded and bond maturities re-financed	€232 billion
Capital Economics	Core states are required to fund peripheral countries' budget deficits for next ten years	€152 billion
Capital Economics	Core states are required to fund a reduction in peripheral debt levels to 90 per cent of gross domestic product by 2020 while peripheral economies undergo internal devaluation to restore competitiveness	€99 billion
Capital Economics	**Core states are required to fund a reduction in peripheral debt levels to 90 per cent of gross domestic product by 2020**	**€74 billion**

Source: Charles Dumas, *The Netherlands and the euro* (Lombard Street Research, London), 2012. pp 1-2. Jonathan Loynes, *The costs of keeping the euro together versus a break-up*, confidential briefing note for clients (Capital Economics, London), 2013.

Figure 13: Comparison of forecasts for Dutch gross government debt as a share of gross domestic product



Source: Eurostat, International Monetary Fund (October 2013), European Commission (November 2013), *Centraal Planbureau* (August 2013) and Capital Economics

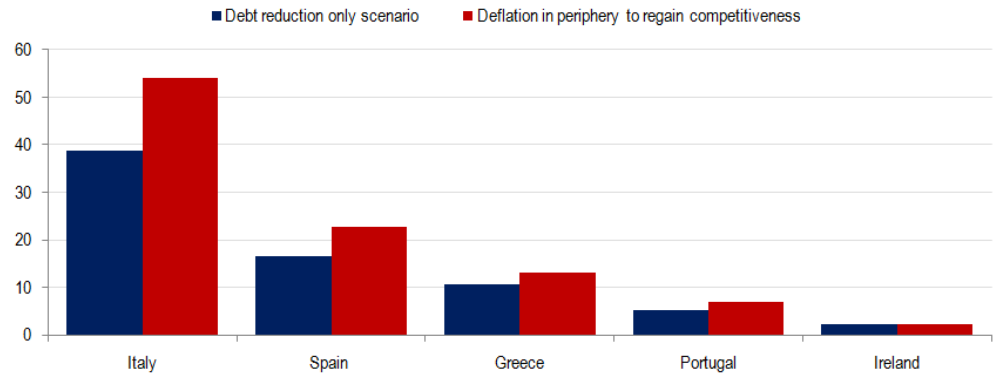
We have simulated the impact of our two baseline scenarios on Dutch government debt levels. Under the 'no further periphery support' scenario, debt levels fall gently through the Maastricht benchmark of 60 per cent of gross domestic product after 2025. If the periphery is fully supported, debt plateaus within the range of 70 to 80 per cent into the medium term. For Dutch membership of the euro to remain sustainable, substantial fiscal retrenchment will be needed to offset any bailouts to the periphery. Although the timing and scale of such cuts are impossible to predict with precision, we assume the Netherlands implements further austerity measures after 2027,

which allows the ratio of government debt to gross domestic product to fall to 'no further periphery support' levels by 2035. (See Figure 13.)

The euro-zone's imbalances are not limited to government debt. In the euro, wages and prices in peripheral states have risen faster than the core to the detriment of their competitiveness – but, without their own currencies, these price differences cannot be rebalanced through exchange rate devaluations. Instead, the Mediterranean countries must rely on so-called 'internal devaluation' or, in other words, wage deflation. This would further exacerbate their government debt to gross domestic product ratios.

Although not included in our baseline scenarios, we have estimated the scale of devaluation required by assessing the difference in competitiveness between Germany and the peripheral states – and then calculating the extra contribution required from the core countries for the peripheral states to meet the 90 per cent debt level. Based on these estimates, the Netherlands' contribution would increase by €25 billion. (See Figure 14.)

Figure 14: Netherlands' potential fiscal transfers to periphery, € billions



Source: Capital Economics' analysis of Eurostat and International Monetary Fund data

Moreover, fiscal transfers to the peripheral nations are only one of the risks of staying within the European Union. Prospects for the Netherlands within the union may be jeopardised by, for example: a regulatory process that makes Europe increasingly uncompetitive; a higher risk premium attached to borrowing owing to the contingent risk posed by the euro-zone; a poorly managed disintegration of the whole euro-zone, with widespread default by peripheral economies; and trade policy that does not enhance the advantages of the Dutch economy. None of these, nor any of the other risks associated with membership of the European bloc, are factored into our baseline – but they are nevertheless real hazards facing a Dutch economy remaining inside.

Conclusion

Exiting the European Union is, without doubt, a substantial political, economic and even social step for any member state to make. Equally however, any decision (or, more likely, indecision) to stay within the bloc is no less significant – nor is it any less likely to result in future change. The Europe of tomorrow will not be the Europe of today, regardless of whether the Netherlands remains part of the union.

Indeed, looking ahead, membership of the European Union does not provide a prosperous future for the Netherlands – even if there are no further crises in the peripheral euro-zone countries (which we think is unlikely). In the near term, the economy will be one of the slowest in northern Europe to recover from the recessions following the 2008/9 credit crunch. Thereafter, rates of growth appear set not only to be much lower than those in Asia, Africa and America, but also of key European competitors, including those outside the euro-zone and the union. Moreover, even after the current problems are distant history, the Netherlands' rate of economic growth looks set to underperform its historic averages. The exact numbers in our own forecasts are sometimes more pessimistic than those of some other commentators. But all paint a similar picture. Staying in the union provides no economic panacea.

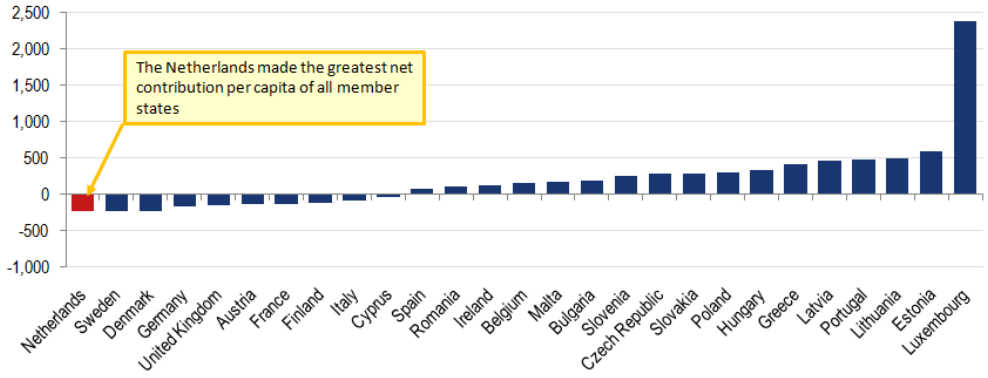
And, there are further significant downside risks to this less-than-rosy prognosis. Although the euro-zone crisis appears to have abated, the structural problems that underlie the currency bloc mean that either additional substantial bailouts of indebted peripheral nations will be required, or the euro must break-up, or both.

3 PUBLIC FINANCES

In this chapter, we consider the first of the potential benefits from leaving the European Union: improving Dutch public finances by reducing or even eliminating the contribution to European Union spending programmes.

For 2012 (the most recent year for which full detailed information was available at time of writing), the European Commission estimate that the Dutch contributed €6.1 billion to the European Union controlled budget, of which €4.0 billion was spent on programmes outside the Netherlands.[3] This 'net' contribution is equivalent to over half of a percentage point of national income, or €237 for each member of the Dutch population. No member state made a greater net contribution in 2012 per person than the Netherlands: Germany's was €171; the United Kingdom's only €146; and, at almost half the Dutch contribution, France's was €129. (See Figure 15.)

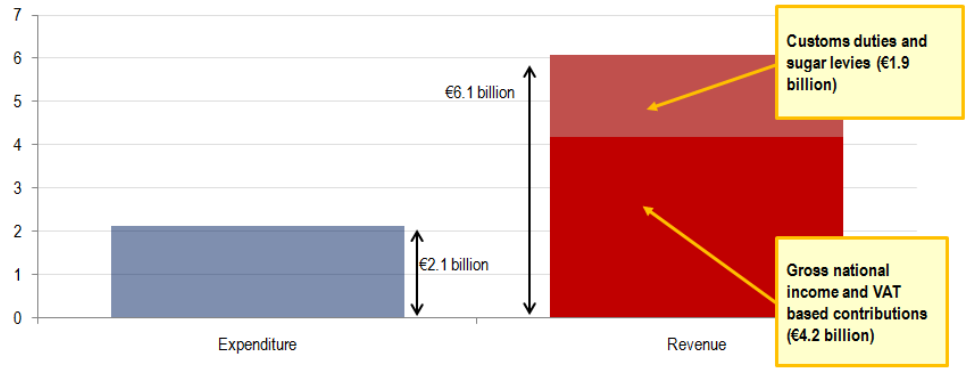
Figure 15: Per capita net contributions to the 2012 European Union budget, euros



Source: European Commission, Eurostat

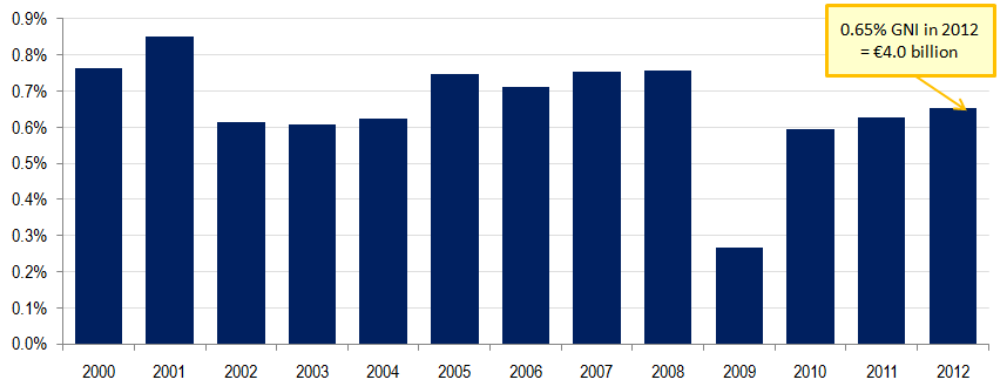
[3] European Commission, *EU budget 2012 Financial Report* (Publications Office of the European Union, Luxembourg), 2013. pp107
Note that some Dutch government figures report a contribution of €6.7 billion in 2012. However, this does not include a rebate that the Netherlands receives on its contribution to the United Kingdom rebate. (See Chapter 14 for further discussion of the rebate.)

Figure 16: Netherlands' share of European Union revenue and expenditure, 2012, € billions



Source: European Commission, *EU budget 2012 Financial Report* (Publications Office of the European Union, Luxembourg), 2013. pp107

Figure 17: Netherlands' net contribution to the European Union budget as a share of gross national income



Source: European Commission

By leaving the European Union, the Netherlands can recover some of its net contribution as it will no longer be bound into commonly agreed pan-European spending programmes. Of course, it may not repatriate of all of its net contribution; some countries, like the members of the European Economic Area, who are outside the European Union opt to pay in to Brussels' coffers as part of bilateral or multilateral arrangements to, for example, access the European single market or for other mutually beneficial arrangements.

Two such countries are Norway, which joined the European Economic Area in 1994, and Switzerland, which is the only member of the four-nation European Free Trade Association that hasn't also signed up to the economic area agreement. Indeed, Norway is integrated into a wide range of European Union programmes, which extend beyond the requirements of the single market. (See Figure 18.)

Figure 18: European Union programmes with Norwegian participation, 2010

Source: Norwegian Ministry of Foreign Affairs, *Norway and the EU – partners for Europe* (Norwegian Ministry of Foreign Affairs, Oslo), 2011.

In 2012, Norway paid contributions to Brussels of nearly €0.6 billion and we estimate for Switzerland just under €0.5 billion[4], which were 0.15 per cent and 0.10 per cent of their gross national incomes respectively. (These numbers are 'gross' figures i.e. they do not deduct any spending from European Union budgets in these countries.) (See Table 1.)

[4] Integration Office FDFA/FDEA, *Bilateral agreements Switzerland-EU* (Integration Office FDFA/FDEA, Bern), 2009. pp43.

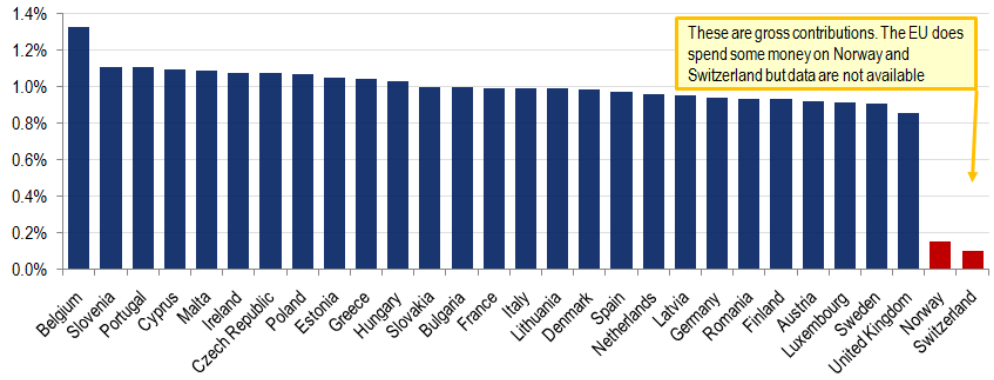
Table 1: Estimated gross contributions to the European Union budget, 2012

	Norway	Switzerland
	€ million	€ million
EEA grants	189	-
Norway grants	160	-
EEA/EFTA commitment to EU operational costs	236	-
EFTA budget (2012)	10	-
Total	**596**	**498 (CHF 600m)**
As a share of GNI (2012)	***0.15%***	***0.10%***

Source: EEA Grants – Norway Grants, *EEA Grants - Norway Grants Annual Report 2012* (EEA Grants - Norway Grants Financial Mechanism Office, Brussels), 2013. pp7. Anna Hedh and Irene Johansen, *Report on EU programmes 2014-20 and the participation of the EEA EFTA* States (European Economic Area Joint Parliamentary Committtee, Brussels), 2012. pp5-6. Tore Grønningsæter, *This is EFTA 2012* (EFTA, Brussels), 2012. pp 26. Integration Office FDFA/FDEA, *Bilateral agreements Switzerland*-EU (Integration Office FDFA/FDEA, Bern), 2009. pp43.

These Norwegian and Swiss contributions are a small fraction of those made by the full members of the European Union. For comparison, the gross contributions of the members in 2012 ranged from 0.84 per cent of gross national income for the United Kingdom (with its perennially contentious rebate) through 1.01 per cent for the Netherlands to 1.39 per cent for Belgium. (See Figure 19.)

Figure 19: Gross contributions to the European Union budget as share of gross national income, 2012



Source: European Commission, *EU budget 2012 Financial Report* (Publications Office of the European Union, Luxembourg), 2013, Eurostat, and see Table 1 sources for Norway and Switzerland

The precise scale of any contributions to be made by authorities in *Den Haag* to the European Union's budgets (and *vice versa*) after NExit will depend upon the final outcome of negotiations regarding the future relationship between the Netherlands and the bloc.

We have examined what the impact on Dutch public finances might be under three different exemplar negotiated outcomes:

- a Swiss-like arrangement where the Netherlands joins the European Free Trade Association and makes bilateral agreements with the European Union, where we assume that the Dutch make contributions to the union on an equivalent basis to those made by Switzerland

- a Norwegian-like arrangement where the Netherlands joins the European Economic Area and this determines its relations with the bloc, where we assume that the Dutch make contributions to the union on an equivalent basis to those made by Norway

- a complete break with the European Union whereby relations are based upon World Trade Organisation agreements and protocols, where we assume that the Dutch make no contributions to the union

For our calculations across all three examples, we assume that the Netherlands ceases to charge duties and levies currently set and mandated by the European Union. However, by cutting import duties and sugar levies, Dutch authorities will lose revenues equivalent to approximately 0.11 per cent of gross national income (which is the quarter share of 'traditional own resource revenue' that each member state is allowed to keep).[5]

There are meaningful savings to be made if the negotiated outcome looks similar to current Swiss or Norwegian arrangements as well as if there were a complete break. A Norwegian-like settlement with the European Union would liberate some 0.4 per cent of gross domestic product each year of Dutch taxes from funding Brussels' spending in other countries, while a Swiss-like arrangement would free up 0.45 per cent annually. Meanwhile, a complete break from the union would bolster Dutch public finances by 0.55 per cent of gross domestic product, or €4.7 billion by 2035 (in today's prices).These estimated savings are the minima. More can – and, with appropriate government action, is likely to – be achieved.

So far, we have looked only at the benefit of reducing that part of Dutch payments to Brussels that fund European Union expenditure in other countries. NExit may save more than this 'net contribution'. In addition, savings can be made by cutting some or all of the union's expenditure in the Netherlands, which are all funded by the remainder of Dutch taxpayers' contributions.

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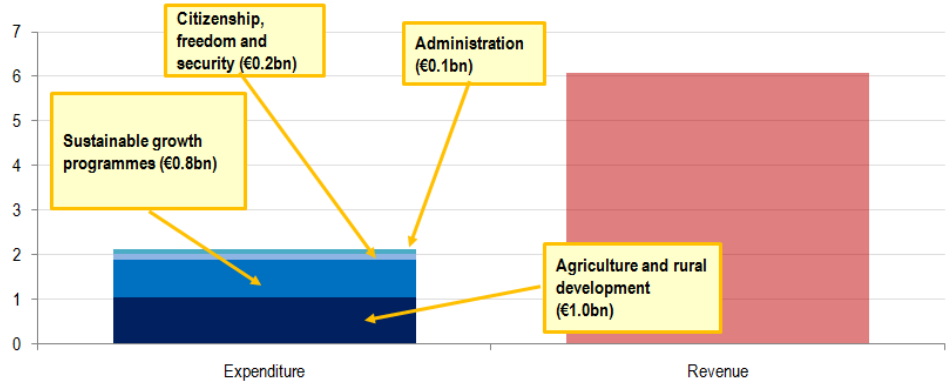
[5] European Commission, *EU budget 2012 Financial Report* (Publications Office of the European Union, Luxembourg), 2013. pp107 and European Commission, *European Union Public Finance 4th Edition* (Office for Official Publications of the European Communities, Brussels), 2008. pp238

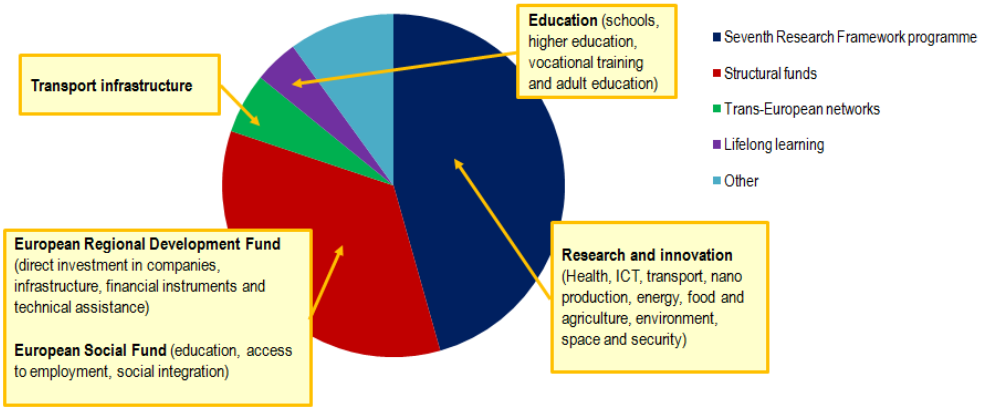
In 2012, the European Union was responsible for some €2.1 billion of public expenditure in the Netherlands. As a net contributor, all of this was effectively funded by Dutch taxpayers. The common agricultural policy was the largest area of Brussels-dictated spending in the Netherlands, followed by a collection of policies called the 'sustainable growth programmes'. This is not the place to evaluate the relative merits or otherwise of each individual programme. However, it would be no surprise if this €2.1 billion included some spending that was inefficient, ineffective or irrelevant. Outside of the European Union, it will be possible to review and reduce these spending programmes – to the benefit of Dutch public finances of up to 0.35 per cent of gross domestic product. (See Figure 20 and Figure 21.)

Figure 20: Netherlands' share of European Union revenue and expenditure, 2012, € billions



Source: European Commission, *EU budget 2012 Financial Report* (Publications Office of the European Union, Luxembourg), 2013. pp107

Figure 21: Composition of the European Union's sustainable growth expenditure in the Netherlands



Source: European Commission, EU budget 2013 (Publications Office of the European Union, Luxembourg), 2013. pp10

Conclusion

With NExit, Dutch authorities can extricate themselves from their current commitment to part fund European Union programmes and policies, and use the money to pay for domestic policies, reduce taxes, pay-down government debt or a combination of all three.

Reducing or removing direct payments to Brussels will improve Dutch public finances, while further savings could well be achieved by reviewing and reducing public spending (such as that under the common agricultural policy) currently conducted in the Netherlands under the auspices of the European Union but effectively funded by Dutch taxpayers.

4 REGULATION

In this chapter, we consider a second potential benefit from leaving the European Union: reducing the costs of doing business by withdrawing from pan-European industrial and commercial regulations.

The 'family' of European Union organisations can legislate, regulate and intervene across the most extensive range of economic activities and throughout business and commercial life – with an impact on costs and competitiveness. Their 32 areas of activity cover everything from agriculture and audiovisual through energy, environment and employment policy to taxation and transport. (See Table 2.)

Table 2: Activities of the European Union

European Union	Agriculture	Audiovisual and media	Budget
	Competition	Consumers	Culture
	Customs	Development	Economic and monetary affairs
	Education, training, youth, sport	Employment and social policy	Energy
	Enlargement	Enterprise	Environment
	External relations	External trade	Fraud
	Food safety	Foreign and security policy	Humanitarian aid
	Human rights	Information society	Institutional affairs
	Internal market	Justice, freedom and security	Maritime affairs and fisheries
	Public health	Regional policy	Research and innovation
	Taxation	Transport	

Source: Refer to the European Union website: http://europa.eu/pol/ (accessed 07-01-2014)

This partly reflects the demands of establishing and maintaining a single market across member countries. A properly functioning internal market requires common rules in areas such as: consumer protection; product standards; company law; competition and state aid; some employment policy (such as health and safety at work); and statistics. If the Netherlands wished to negotiate access to the single market after withdrawing from the union at large, it is likely that many of the business regulations in these areas would remain enforced. It is estimated that Norway implements 75 per cent of European legislation[6], although the figure is somewhat less for Switzerland.[7]

Of course, there may be good reasons for the public sector to regulate or intervene in business activities. These include: economic efficiency; consumer

[6] Report by the EEA Review Committee, *Outside and Inside – Norway's agreements with the European Union*, (Norwegian Ministry of Foreign Affairs, Oslo), 2012. Refer to Chapter 28.2 at http://www.regjeringen.no/nb/dep/ud/dok/nou-er/2012/nou-2012-2/29/2.html?id=669881 (in Norwegian) (accessed 07-01-2014)

[7] See Daniel Hannan blog on *Telegraph* website at http://blogs.telegraph.co.uk/news/danielhannan/100186074/ (accessed 07-01-2014)

welfare; environmental protection; restraining monopoly, excessive market power and cartels; and protecting the health and safety of workers and the public.

However, any such benefits of regulation come at a cost to business:

- Administrative burdens: the costs to businesses of, for example, providing authorities with required information, record-keeping, public reporting and other such tasks that they would not have had to undertake otherwise

- Policy cost: both the initial and ongoing costs of restructuring business processes and activities to meet the regulatory requirements

- Wider knock-on costs: the impact through supply chains of higher prices and/or restricted supplier activities (e.g. wholesalers and retailers are impacted by the regulation of the transport and logistics sector)

In addition, there are costs borne by the public sector in establishing and running the relevant regulatory authorities, and their monitoring, policing and enforcement activities.

The costs to business of such regulations are non-trivial.

A comprehensive study of these costs in the Netherlands found that they totalled €16.4 billion in 2003, including both domestic and European regulations.[8] But since then the Netherlands has made significant progress in reducing its administrative burdens, with estimates of the scale of this reduction suggesting that they now stand at around €9.6 billion.[9]

Meanwhile, the European Commission estimated, for 2007, that European Union legislation imposed a total administrative burden on businesses of €124 billion, which is equivalent to one per cent of the bloc's gross domestic product.[10] (See Figure 22.) A further review conducted in 2012 suggests that this had fallen by 25 per cent (although this does not account for any new administrative costs introduced).[11] If this is representative of the costs in the

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8 George Gelauff and Arjan Lejour, *An Estimation of the impact of reaching five Lisbon Targets* (*Centraal Planbureau*, *Den Haag*), 2006.pp 103

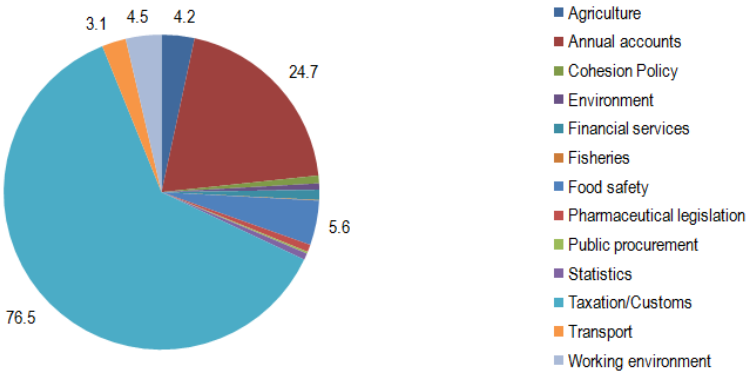
9 Simeon Djankov and Peter Ladegaard, *Review of the Dutch Administrative Simplification Programme* (The World Bank Group, Washington), 2008. pp 1-5

10 *Adviescollege toetsing regeldruk et al, The End of the Commission's Action Programme for Reducing Administrative Burdens in the European Union – What comes next?* (ACTAL, *Den Haag*), 2011. p2

11 European Commission, *Action Programme for Reducing Administrative Burdens in the EU Final Report* (European Commission, Strasbourg), 2012. p3

Netherlands, €4.3 out of the €9.6 billion administrative burden is spent annually on the administration of Brussels' regulations, which is equivalent to 0.7 per cent of Dutch gross domestic product. And this doesn't even include the policy or wider knock-on costs let alone the bureaucratic costs to the public sector of the regulator regime itself.

Figure 22: Estimated administrative burden on businesses of European Union legislation, 2007, € billions



Source: European Commission, *Action Programme for Reducing Administrative Burdens in the EU. Delivering on promises* (Office for Official Publications of the European Communities, Luxembourg), 2010. p8

The administrative burden is only part of the drag on business and the economy imposed by regulations. Adding in the policy cost, estimates of the combined burden vary from ½ to three per cent of gross domestic product. (See Table 3.)

Table 3: Estimates of the administrative and policy costs of European Union regulations

Source	Scope	Key findings
Ian Milne, *A Cost Too Far?* (Hartington Fine Arts, Lancing), 2004. p5	• Estimate of net impact based on unsubstantiated assumptions about wider costs and the benefits of regulation	• The cost of EU regulation (administrative and policy) is between **0.5 and 3%** of GDP
Sarah Gaskell and Mats Persson, *Still out of control?* (OpenEurope, London), 2010. p1	• Estimate of annual gross cost in 2009	• The cost of EU regulation (administrative and policy) is **1.4%** of GDP
Better Regulation Task Force, *Regulation – Less is more* (Cabinet Office Publications & Publicity Team, London), 2005. p13	• Analysis of administrative costs relative to policy costs	• Administrative costs are around 30% of total costs (Based on our review of administrative costs this implies a combined cost of **2.3%** of GDP in the Netherlands)

Source: As indicated.

In addition, there are wider 'knock-on' costs, which could be substantial as the additional costs borne by regulated businesses are passed on through the supply chain into more and more enterprises, and eventually to consumers themselves. Moreover, poorly formulated regulations can distort markets by altering the relative prices of goods and services in a way that does not reflect their underlying economic costs, and may lead to an inefficient allocation of

resources. These wider costs are rarely measured by impact studies, although some researchers have suggested the overall costs of all regulation could be in the order of ten per cent of national income. (See Table 4.)

Table 4: Estimates of the wider knock-on costs of regulation

Estimates of the wider costs of all regulation (European and national) on the economy	
Tim Ambler and Keith Boyfield, *Route Map to Reform: Deregulation* (ASI (Research) Ltd., London), 2005. p37	A paper published by the Adam Smith Institute estimates that the direct compliance costs of regulation amount to 5% in Europe, but they suggest it would be around 10% if indirect costs were also included.
Open Europe, *Less Regulation: 4 Ways to cut the Burden of EU Red Tape* (Open Europe, London), 2005. p10	Sir David Arculus, the head of the Better Regulation Task Force, stated that the total cost of regulation in the United Kingdom is between 10 and 12% of GDP.

Sources: As indicated.

The evidence from the United Kingdom is that the magnitude of costs imposed by different European regulations range widely. A detailed study by a London and Brussels based business think tank, Open Europe, reviewed the 100 most costly regulations since 1998 for British business. They found that almost one fifth (eighteen per cent) of the total administrative cost of all 100 regulations were attributable to just one: the working time directive. Certain environmental, employment and motor vehicle industry regulations were also among the most expensive. (See Table 5.)

The actual costs borne by a specific business will, of course, depend on a number of factors. For example, a European Commission survey of small and medium sized businesses produces a list of most burdensome regulations that has its differences to that produced by Open Europe. (See Table 6.)

Moreover, the costs of regulations will be different in different countries. For example, although the working time directive is a particular bane of British business, it will have had less of an impact in other countries, like the Netherlands, with a prior history of shorter or restricted working hours. In 2012, 67 per cent of Dutch employees worked fewer than 40 hours per week, compared with an average of 36 per cent across all countries in the Organisation for Economic Co-operation and Development.[12]

[12] Organisation for Economic Co-operation and Development's statistics database

Table 5: Most costly European regulations for United Kingdom businesses as indentified by Open Europe

Most costly EU regulations as identified by Open Europe (cover 53% of top 100 in UK)		As share
Working time directive	Directive 93/104/EC (HAD 2000/34/EC)	18%
Climate Action and Renewable Energy Package	Climate Action and Renewable Energy Package	15%
Energy performance Certificates for buildings (Home Information Packs)	Articles 3 to 6, Directive 2002/91/EC	11%
The Temporary Agency Workers Directive	Directive 2008/104/EC	8%
The Vehicle Excise Duty (Reduced Pollution) (Amendment) Regulations 2000	Directive 1999/96/EC	8%
The Motor Vehicles (EC Type Approval) (Amendment) Regulations 2008	Directives 2007/34/EC, 2007/35/EC, 2007/37/EC; and Regulations (EC) No 715/2007, 706/2007	6%
Data Protection Act	Directive 95/46/EC	5%
Water Environment (Water Framework Directive) Regulations 2003	Directive 2000/60/EC	3%
The Working Time (Amendment) Regulations 2002	Directive 94/33/EC	3%
Control of Vibration at Work Regulations 2005	Directive 2002/44/EC	2%
The Genetically Modified Food (England) Regulations 2004	Regulation (EC) No. 1829/2003, 1830/2003	2%
The Sale and Supply of Goods to Consumers Regulations 2002	Directive 1999/44/EC	2%

Grey= tied to single market membership

Source: Capital Economics' analysis of European Commission website and Open Europe blog December 21 2009, *The top 100 most costly EU regulations*, (Open Europe, London), 2009.

Table 6: Most commonly identified burdens by small and medium sized enterprises

Most commonly cited burdens as identified by SMEs in an European Commission survey	
Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH)	Regulation (EC) No 1907/2006
Refund of value added tax to taxable persons established in another Member State	Council Directive 2008/9/EC
Common system of value added tax	Council Directive 2006/112/EC
General product safety	Directive 2001/95/EC
Working time directive	Directive 2003/88
Measures to encourage improvements in the safety and health of workers at work	Council Directive 89/391/EEC
Recognition of professional qualifications	Directive 2005/36/EC
Packaging and packaging waste	Directive 94/62/EC
Procedures for the award of public works contracts, public supply contracts and public service contracts	Directive 2004/18/EC
Modernised Customs Code	Regulation (EC) No 450/2008
Statistics relating to the trading of goods between Member States	Regulation (EC) No 638/2004
Recording equipment in road transport for driving and rest periods	Council Regulation (EEC) No 3821/85

Grey= tied to single market membership

Source: Capital Economics' analysis of European Commission website and Open Europe blog December 21 2009, *The top 100 most costly EU regulations*, (Open Europe, London), 2009.

There is now a weighty and compelling literature to demonstrate a negative relationship between regulatory costs and economic growth. Countries where there are lower regulatory burdens on business experience materially higher rates of economic growth – and *vice versa*. (See Table 7.)

Indeed, the Dutch government's own independent policy research and analysis organisation, *Centraal Planbureau*, quantified the benefit that can be accrued from reducing regulatory costs. They estimated that, if the Netherlands achieved the demands of the so-called 'Lisbon Agenda', which was the action and development plan agreed by the European Council during the Portuguese presidency of 2010, and delivered a 0.9 per cent cut in the

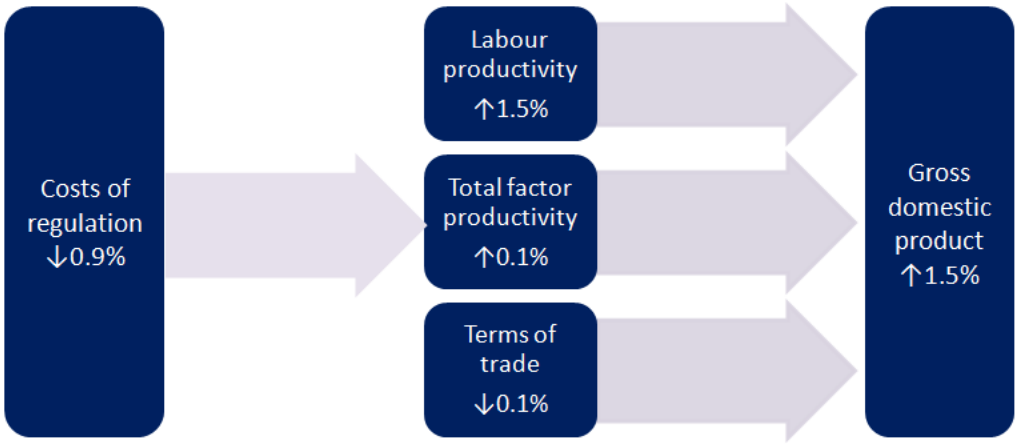
regulatory burden, Dutch gross domestic product would receive a boost of 1.5 per cent. (See Figure 23.)

Table 7: Example studies demonstrating the relationship between economic performance and regulation

Study	Findings
John Dawson, *Regulation, investment, and growth across countries* (Cato Journal, vol.26, No.3), 2006. pp489-509	• Statistically significant negative relationship between a broad measure of regulation and growth. • Similar results are found when measures of credit market and business regulations are used.
John Dawson and John Seater, *Federal Regulation and Aggregate Economic Growth* (Journal of Economical growth, vol.18, issue 2), 2013. pp137-177	• Regulation has statistically and economically significant effect on aggregate output • Regulation has caused substantial reductions in the growth rates of both output and TFP and has had effects on the trends in capital and labour that vary over time in both sign and magnitude. • Regulation changes the way output is produced by changing the mix of inputs. Changes in regulation offer a straightforward explanation for the productivity slowdown of the 1970s.
Simeon Djankov, Caralee McLiesh, Rita Maria Ramalho, *Regulation and growth* (Economics Letters, Elsevier, vol. 92(3), September), 2006. pp395-401	• Improving from the worst (first) to the best (fourth) quartile of business regulations (as measured by the World Bank Doing Business indicators) implies a 2.3 percentage point increase in average annual growth.
Frontier Economics, *The impact of regulation on growth* (Frontier Economics, London), 2012. pp1-78	• Product market regulations can have a negative and significant impact on economic growth. • The literature indicates that planning regulation can change the relative price of factor inputs (e.g. land, office space, etc.) and therefore have a negative impact on productivity in specific sectors. • Environmental regulation may have a net positive impact on growth if positive effects on firm innovation offset the compliance costs. However, the empirical evidence appears to be mixed and the outcome depends on the regulatory design and type of regulation.
Henk Kox, *Lack of imports and overregulation matter* (CPB Netherlands Bureau for Economic Policy Analysis, The Hague), 2012. pp1-20	• Markets for business services work best in countries with flexible regulation on employment change and with low regulatory costs for firms that start-up or exit a business.
Bjorn Falkenhall and Johan Ekland, *The Economic Effects of the Regulatory Burden* (Swedish Agency for Growth Policy Analysis), 2010	• There are strong theoretical indications that the indirect economic consequences of the regulatory burden are significant. • Regulations impose barriers to entry which negatively affect entrepreneurship, reduce companies' ability to adapt to changes in its environment and increase the yield requirement on investments.
Robert Clark and Laurent Da Silva, *Regulation and* Growth (Centre for Productivity and Prosperity, Montreal), 2009.	• Regulation can act as a disincentive to invest if it reduces the value of investment projects. • Low productivity firms sometimes retain place in the market because regulation explicitly prevents new entrants or because of other anti-competitive legislation such as price floors.

Sources: As indicated.

Figure 23: *Centraal Planbureau* findings on the economic impact of reducing the costs to business of regulations

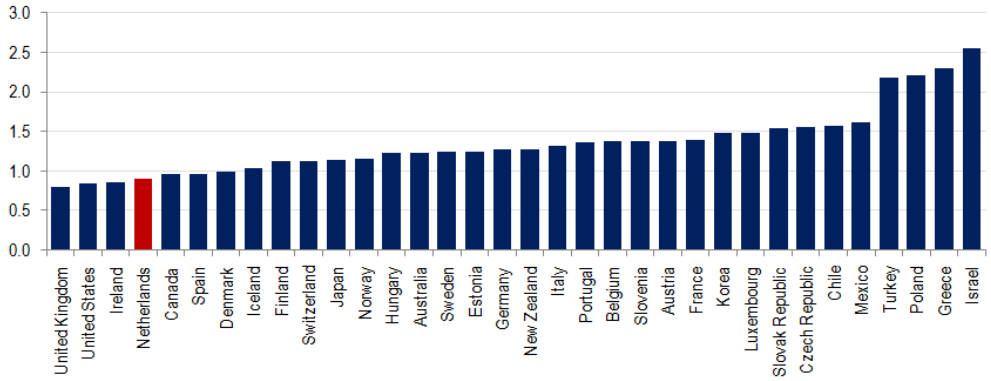


Source: George Gelauff and Arjan Lejour, *The new Lisbon strategy - An estimation of the economic impact of reaching five Lisbon Targets* (Office for Official Publications of the European Communities, Luxembourg), 2006. pp104-106

By leaving the European Union, Dutch authorities will be free to repeal or amend Brussels originated regulations and reduce the burden on businesses. There may be some areas currently regulated by Brussels where the legislation can be withdrawn completely – but these are likely to be the minority. For all others, the pan-European regime will be replaced by a national one.

There are good reasons to believe that, by and large, domestic or local regulation is more effective and efficient than a European-wide system. European Union regulations are one size fits all, and find it difficult to accommodate differences in national markets, customs, interests and conditions. In trying to cover so many national markets, there is a tendency for Brussels' legislation to become overly prescriptive and burdensome. And, they are arguably inflexible and difficult to amend especially when subject to qualified majority vote, which means they may not keep pace with changing global market conditions and technological developments. Meanwhile, the Dutch authorities' track record is somewhat better. According to the Organisation for Economic Co-operation and Development, the Netherlands has one of the most business-friendly regulatory environments across its membership – and the best in continental Europe. (See Figure 24.)

Figure 24: Organisation for Economic Co-operation and Development's product market regulation indicator, 2008 (low = better)



Source: Organisation for Economic Co-operation and Development

Open Europe conducted a detailed review of both national and European regulations in force in the United Kingdom.[13] They examined over 2,300 official government impact assessments on regulation introduced in the United Kingdom between 1998 and 2009, and considered the extent to which their broader benefits were expected to outweigh their costs. (See Figure 25.)

They found that, on average, nationally-derived instruments had a benefit to cost ratio of 2.35 – in other words, the benefits exceeded costs by an amount equivalent to 135 per cent of the costs. For European regulations enforced in the United Kingdom, the ratio was only 1.02 – meaning that their expected benefits were only two per cent greater than their costs. This suggests that either:

[13] Sarah Gaskell and Mats Persson, *Still out of control? Measuring eleven years of EU regulation* (Open Europe, London), 2010. pp1-3

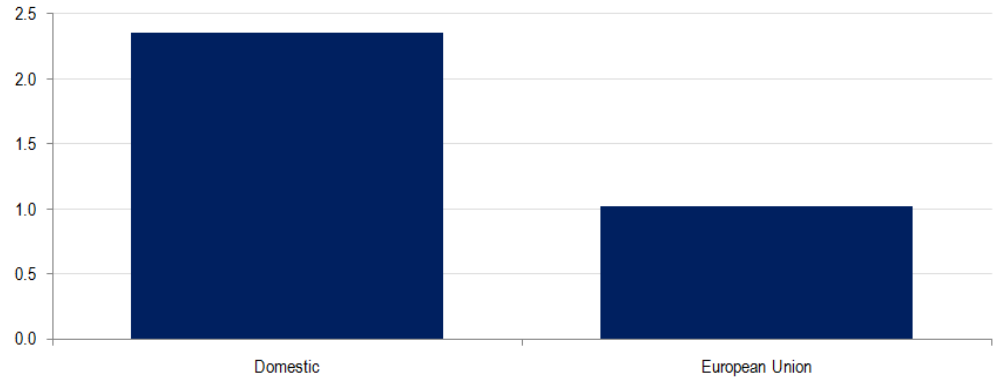
(i) national and local regulatory regimes are much less costly than the pan-European one; or

(ii) European regulations, where one size fits all, deliver much lower benefits than nationally developed ones;

– or (iii), more likely, both.

The scope for the Netherlands to divest itself of European rules and regulations will depend upon whether access to the single market is to be retained. If it is, the European Union is likely to negotiate for a settlement like Norway's or Switzerland's. However, according to *Centraal Planbureau*, 'about eight per cent of Dutch enterprises have exported goods in 2007. A third of these exporting firms have served only one foreign market'.[14] Only these businesses will benefit directly from access to the internal market (although others will indirectly), but all may suffer the costs of additional regulation.

Figure 25: Benefit cost ratio for regulations in the United Kingdom



Source: Sarah Gaskell and Mats Persson, *Still out of control? Measuring eleven years of EU regulation* (Open Europe, London), 2010. pp1-3

Conclusion

Burdensome and prescriptive regulations imposed by Brussels are a cost to Dutch businesses of European Union membership. After NExit, the Netherlands could free itself of much of this burden and employ a more targeted and less onerous regulatory framework – although continued membership of the internal market, if desired, will be dependent on adhering to certain related legislation in areas such as product standards and competition policy.

[14] Harold Creusen and Arjan Lejour, *Uncertainty and the export decisions of Dutch firms* (*Centraal Planbureau, Den Haag*), 2011. p3

Quantifying the potential gains is not straightforward; the majority of the empirical analysis on the cost of such regulations is rather weak, focussing only on broad estimates of the gross costs and ignoring any potential benefits. But a thorough study in the United Kingdom finds that domestic legislation is nearly 2½ times more efficient than that of the European Union, and there is no reason to think that this is any different in the Netherlands.

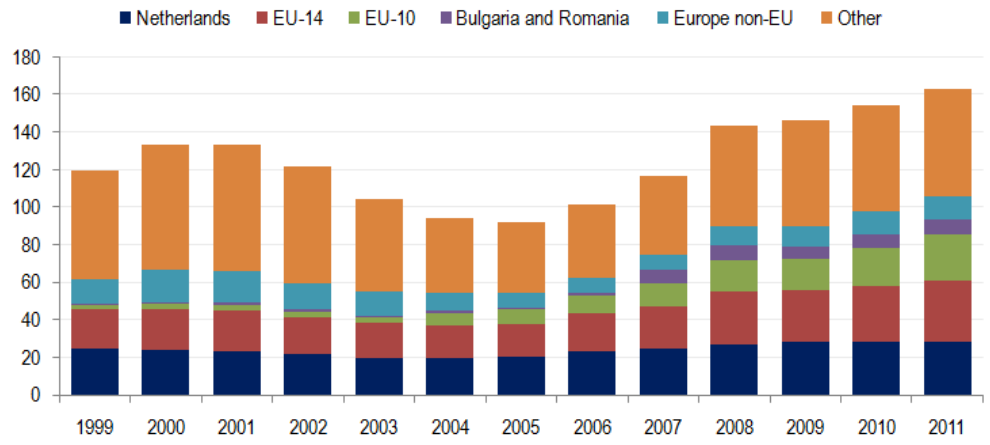
5 IMMIGRATION

In this chapter, we consider a third potential benefit from leaving the European Union: greater control over immigration.

The European Union influences the way in which Dutch authorities can develop and implement immigration policy not only for citizens of other member states but also for those from beyond the union. With NExit, the Netherlands could make its own decisions about the appropriate scale and nature of immigration, and better tune its border policies to meet its economic interests.

In recent years more than 150,000 immigrants have arrived in the Netherlands annually, including around 50,000 from 'non-western' countries. And, although there are swings from year to year, globalisation ensures that the underlying trend is upwards. (See Figure 26.)

Figure 26: Immigration inflows, 2011 numbers by country of birth



Source: *Centraal Bureau voor de Statistiek*
Note: The Centraal Bureau voor de Statistiek classifies immigrants as 'western' or 'non-western'. 'Non-western' is defined as persons with a Turkish, African, Asian and Latin-American background.

Immigrants present both costs and benefits to their host countries. Foreign workers increase the supply of labour and are often willing to work for lower wages than the indigenous population, which is a benefit to local businesses but a cost to indigenous workers. And whilst immigrants pay taxes, they also use public services so can be a drain or a benefit to the taxpayer. Whether, overall, immigrants are a net burden or benefit to the local population depends on the specific characteristics of the incoming groups and the places in which they arrive.

Isolating the fiscal impact, different academic studies come to a variety of conclusions on the overall costs and benefits of immigration, depending on the methodology used and the country in question. Several studies on the United Kingdom find a positive net impact on public finances, although the use of alternative accounting methodologies reverses the result.[15] Similarly, it is easy to find studies on the United States which conclude that immigration is a burden on the tax payer as well as those which argue that immigration provides a boost to the economy.[16] What is clear is that not all groups of immigrants are the same. The skill levels and background of immigrants seems particularly important in determining the overall impact. The literature suggests that lower skilled immigrants from poorer countries will tend to be a burden on the tax payer, while the opposite is true for highly skilled immigrants from richer countries.[17] And of course, this is not something that the Netherlands can control as a member of the European Union.

For the Netherlands, we have little specific and rigorous evidence on the impact of western migration (including intra-European Union immigration). However, there is a compelling case that non-western immigration is a net cost to the Dutch payer. Utrecht-based economic research group, Nyfer, calculate that each annual wave of non-western immigrants costs tax payers €7.2 billion each year (based on 2008 immigration levels in 2008 prices).[18] (See Figure 27 for the lifetime cost of individual immigrants depending on their age at arrival.) The primary reason for non-western immigration in the Netherlands is family re-unification, which accounts for 44 per cent of the inflow of immigrants. Non-western immigrants also go to the Netherlands to study (22 per cent), work (fifteen per cent) and seek asylum (eleven per cent). (See Figure 28.)

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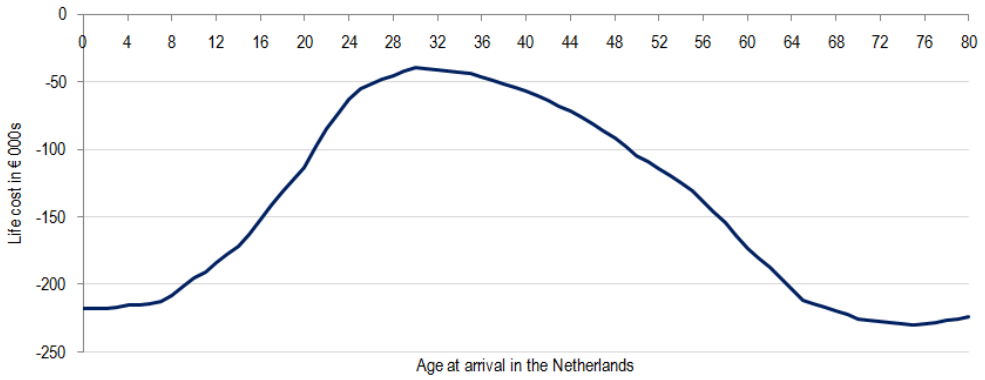
15 For example see Ceri Gott and Karl Johnston, 'The migrant population in the UK: fiscal effects', *RDS Occasional Paper 77*, 2002.
Robert Rowthorn, 'The Fiscal Impact of Immigration on the Advanced Economies', *Oxford Review of Economic Policy*, Vol. 24, Issue 3, 2008. pp 560-580, and then MigrationWatch UK, 'The Fiscal Contribution of Migrants' (MigrationWatch UK, London), 2006.

16 George Borjas, 'The Economics of Immigration', *Journal of Economic Literature*, Vol. 32, No. 4, 1994. pp 1667-1717 and Donald Huddle, *The Net National Costs of Immigration* (Carrying Capacity Network, Washington), 1993 and Ronald Lee and Tim Miller, 'The Current Fiscal Impact of Immigrants and Their Descendants: Beyond the Immigrant Household' in National Research Council, *The Immigration Debate: Studies on the Economic, Demographic, and Fiscal Effects of Immigration* (National Academy Press, Washington), 1998.

17 Kjetil Storesletten, 'Sustaining Fiscal Policy through Immigration', *Journal of Political Economy*, Vol. 108, No. 2, 2000. pp 300-324 and Eskil Wadensjö and H. Orrie, *Immigration and the public sector in Denmark* (Aarhus University Press, Aarhus), 2002.

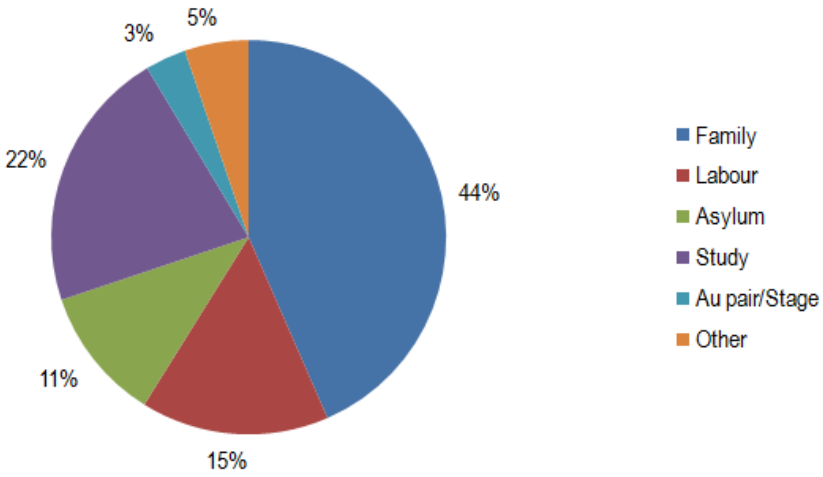
18 L. Van der Geest and A. J. F Dietvorst, *Budgettaire effecten van immigratievan niet-westerse allochtonen* (Nyfer, Utrecht), 2010.

Figure 27: Discounted net lifetime fiscal cost of non western immigrants, based on current return rates and 3% discount rate, 2008 € thousands



Source: L. Van der Geest and A. J. F. Dietworst. *Budgettaire effecten van immigratie van niet-westerse allochtonen* (Nyfer, Utrecht), 2010

Figure 28: Reasons for migrating to the Netherlands, proportion total non-western immigrants 2011



Source: *Centraal Bureau voor de Statistiek*

Once outside the European Union, the Dutch would not have to abide by current constraints on national immigration policy, which will permit better control of non-European Union immigration as well as offering a renegotiation of agreements permitting intra-European union flows. (See Table 8.)

Table 8: European Union directives relating to immigration policy

Directive	Detail	Implication of exit
Directive on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States	Any European Union national has the right to: • look for a job in another European Union country • receive the same assistance from the national employment offices as nationals of their host country • stay in the host country for a period long enough to look for work, apply for a job and be recruited. • Jobseekers cannot be expelled if they prove that they are continuing to seek employment and have a genuine chance of finding a job	European Union non-Dutch immigration could be restricted
Single permit directive	Non European Union workers should enjoy equal treatment as regards social security	A more discriminatory social security regime could be operated
Family reunification directive	Third country residents who have stayed lawfully in their territory for a period not exceeding two years may request to have his/her family members join him/her	Immigration for family reunification could be restricted
Directive on the status of non-European Union nationals who are long-term residents	The status of long-term resident should be awarded after a person has lived legally in an European Union state for an uninterrupted period of five years. This is however dependent upon the person having a stable and regular source of income, health insurance and, when required by the European Union State, having complied with integration measures	There would be no obligation to grant long term residence
Directive on minimum standards for the qualification and status of third country nationals or stateless persons as refugees or as persons who otherwise need international protection	Sets out minimum standards for granting refugee status, identifying specific measures that must be taken into account	Asylum policies to be determined nationally

Source: http://europa.eu/legislation_summaries/index_en.htm (accessed 07-01-2014)

After leaving the union, the Dutch government could stop non-western immigration for the purpose of family re-unification or asylum (which are currently required under the union's family reunification and qualification directives[19]), which would deliver savings to the taxpayer through reduced pension, education, welfare and health costs even after taking account of the taxes that would be paid by those migrants. Together, these classes of immigration account for €4.0 billion of Nyfer's estimated €7.2 billion cost of each annual wave of non-western immigration.

We cannot ignore the impact on labour and capital markets as well. A policy which restricts immigration will tend to lower headline total gross domestic product directly. This is because immigration increases the supply of people working and hence total output, even if there is an increase in overall unemployment and a fall in wages. The Netherlands is no exception to this. Hans Roodenberg *et al* confirm that non-Western immigration does increase headline gross domestic product in the Netherlands.[20] However, they also find that the increased gross domestic product accrues almost entirely to the immigrants themselves, whilst the impact on the existing population is slightly positive or negative, depending on assumptions made about who owns domestic capital.

[19] Council Directive 2003/86/EC of 22 September 2003 on the right to family reunification and Council Directive 2004/83/EC of 29 April 2004 on minimum standards for the qualification and status of third country nationals or stateless persons as refugees or as persons who otherwise need international protection and the content of the protection granted

[20] Hans Roodenberg, Rob Euwals and Harry ter Rele, *Immigration and the Dutch Economy* (*Centraal Planbureau*, *Den Haag*), 2003.

In an analysis of the costs and benefits of policy changes to the Dutch population, it is not meaningful to include output lost to the immigrants themselves, so when considering immigration policy after NExit, the net cost to the Dutch population from reductions in business activity would be close to zero.

Conclusion

Outside of the European Union, Dutch policy-makers can adjust their immigration policies to better fit the needs of their domestic economy.

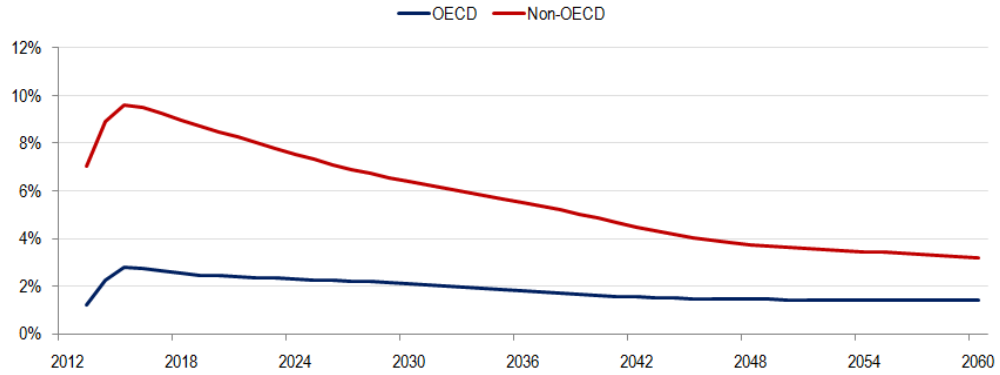
We have not evaluated all of the potential ways in which border rules might be changed. We have focussed only on the requirements to permit non-western immigrants set out in the European Union's family reunification and qualification directives. Opting out of these provisions alone will deliver savings to the taxpayer through reduced pension, education, welfare and health costs.

6 GLOBALISATION

In this chapter, we consider a fourth potential benefit from leaving the European Union: the ability of Dutch authorities to agree their own trade deals with countries across the world and, in doing so, better align their businesses to faster growing emerging markets.

NExit offers the opportunity to redefine Dutch trade relations to reflect the new global economic order. Global patterns of trade, wealth, incomes and growth are changing rapidly.

Figure 29: OECD forecasts for annual percentage change in gross domestic product

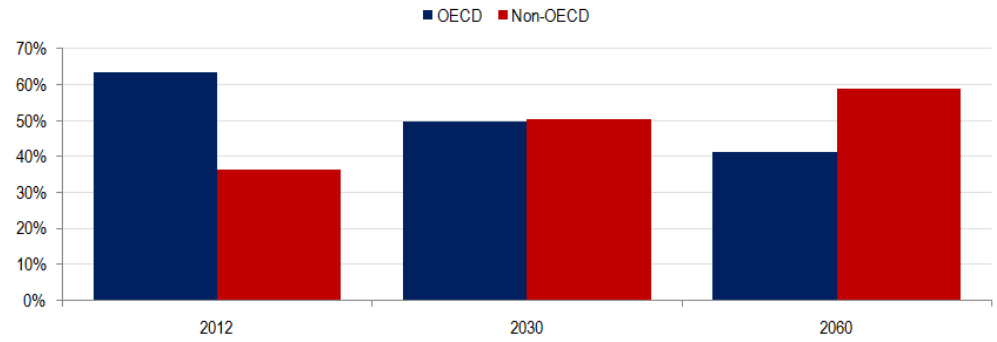


Source: Organisation for Economic Co-operation and Development, *Economic Outlook No.93* (OECD, Paris), 2013

Future global economic growth is set to be concentrated outside of the European Union and other old world 'developed' nations. Brazil, Russia, India and China, the so-called 'BRIC nations', along with other emerging economies, will provide the fastest growing export opportunities as they approach western levels of income and wealth. According to the Organisation for Economic Co-operation and Development, future average growth across its members, which are the established industrialised countries, is set to be between one and three per cent per annum over the coming decades to 2060. Those who aren't members of the Paris-based club can expect growth to average from three to almost ten per cent annually. (See Figure 29.)

By around 2030, the Organisation for Economic Co-operation and Development expects its members to account for just under half of world gross domestic product whereas they currently account for almost 64 per cent. (See Figure 30.)

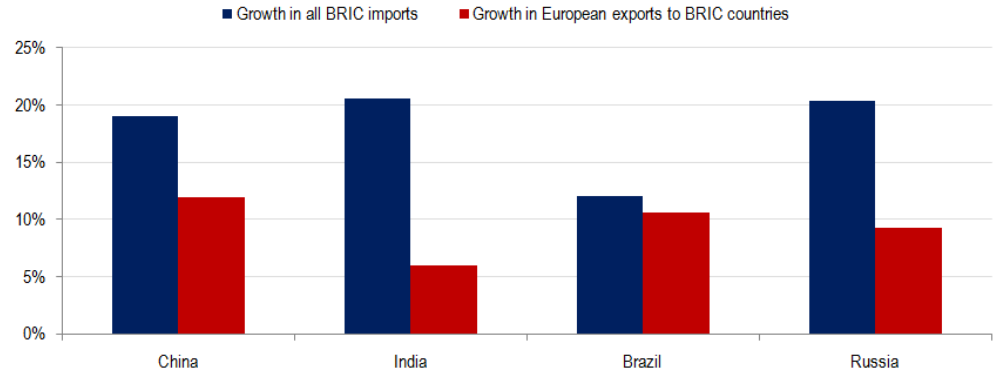
Figure 30: OECD forecasts for share of global gross domestic product



Source: Organisation for Economic Co-operation and Development, *Economic Outlook No.93* (Organisation for Economic Co-operation and Development, Paris), 2013

The European Union has so far failed to capitalise on these fast growing emerging markets. Its exports to the 'BRIC' countries are failing to keep pace with the rate at which they are growing their demand for imports. (See Figure 31.)

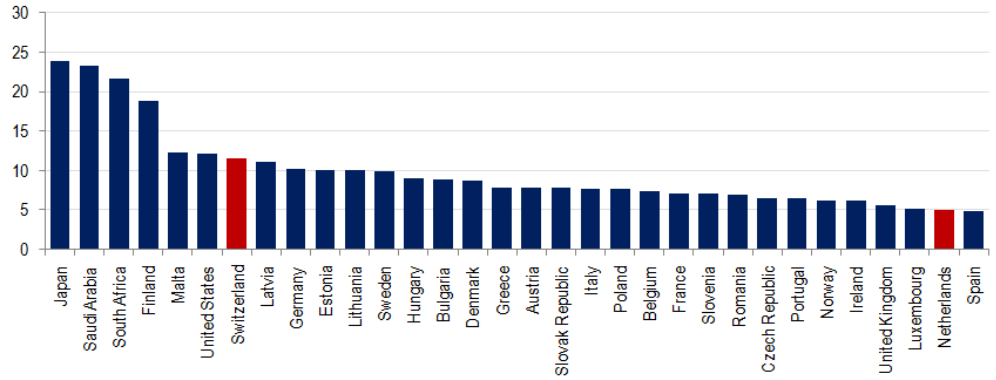
Figure 31: Change in trade in goods between 2000 and 2012, compound annual growth rate



Source: Eurostat and United Nations statistics database

Meanwhile, outside the European Union and negotiating its own trade deals with third party countries, Switzerland has a higher share of exports to the 'BRIC' countries than the Netherlands and almost all other European Union countries. (See Figure 32.)

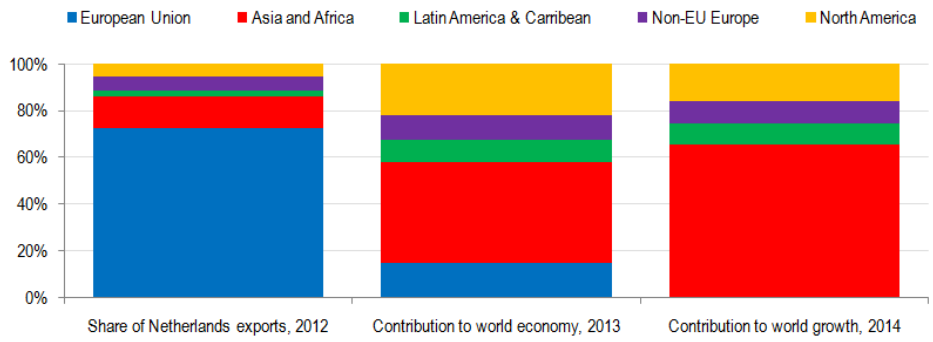
Figure 32: Share of total exports from selected countries destined for the 'BRIC' economies, 2009



Source: Organisation for Economic Co-operation and Development

The Netherlands' external balance is dominated by its trade with other European Union members. They account for 72.5 per cent of exports, whereas only 13.6 per cent are destined for the whole of Africa and Asia combined. Yet, the European economies constitute only 13.7 per cent of the world's economy and are contributing nothing to economic growth currently, when the other two continents are 40.2 per cent and represent almost two-thirds of 2014's expected global growth. And growth in the 'BRIC' and similar economies will continue to outstrip that of Europe for the next two decades, and well beyond. (See Figure 33.)

Figure 33: Structure of the Netherlands' exports versus the global economy and growth



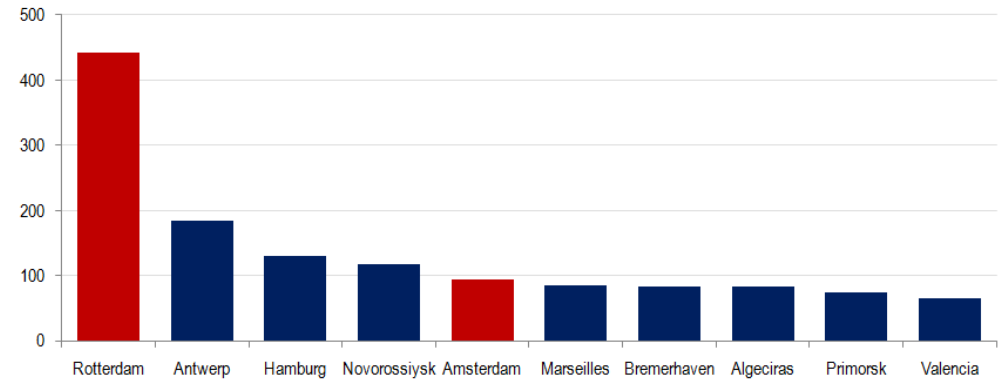
Source: *Centraal Bureau voor de Statistiek* and Capital Economics

It is important to recognise, however, that these headline trade statistics do not reflect the varying underlying value of different imports and exports to the Dutch economy.

Some of the Netherlands' trade derives from its own domestic production, which is exported, and its own domestic consumption, which attracts imports. In addition, the Netherlands' location and transport infrastructure makes it an important gateway into and out of Europe, and a hub for European networks.

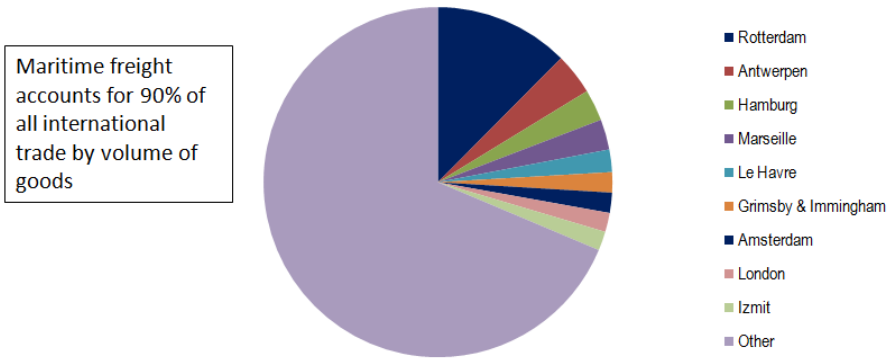
Together, the ports of Rotterdam and Amsterdam handle fourteen per cent of all goods coming into the European Union by sea. Meanwhile, Amsterdam Schipol airport helps make the Netherlands the third most used point of entry for air freight into mainland Europe. (See Figure 34, Figure 35 and Figure 36.)

Figure 34: Top ten European ports by cargo throughput, millions metric tonnes, 2012



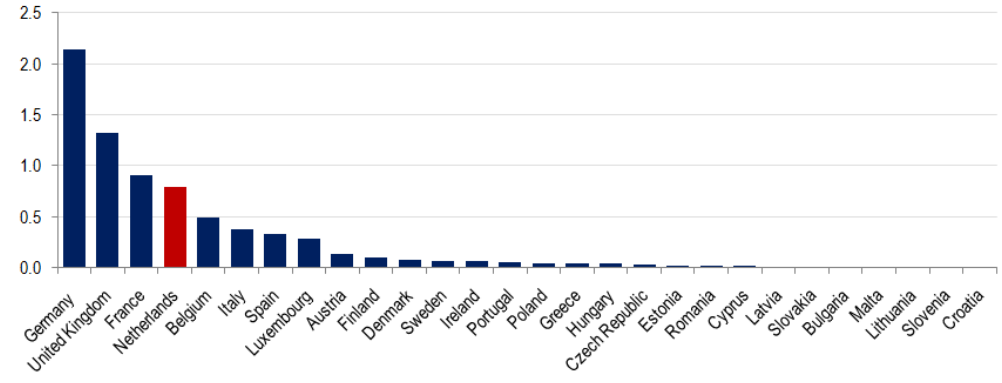
Source: Port of Rotterdam

Figure 35: Inward flow of goods by sea to European ports, tonnes handled in each port, 2011



Source: Eurostat

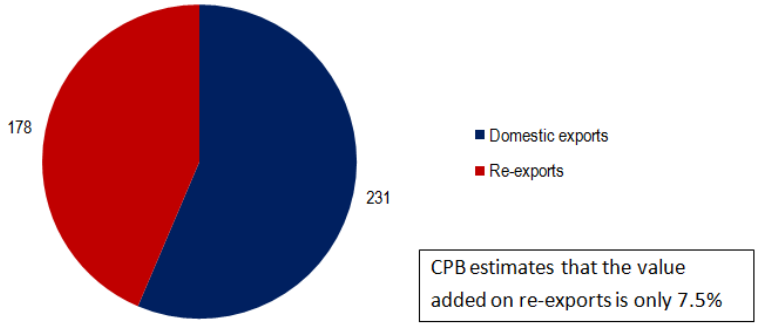
Figure 36: Total freight and mail arriving in the European Union by air, millions tonnes, 2012



Source: Eurostat

As a transit country for goods, many of the imports into the Netherlands are destined to become exports almost immediately, but with little value added in the country. Almost half (45 per cent) of all Dutch exports, as recorded in the official trade statistics, are these so-called 're-exports'. But government statisticians estimate that only 7.5 per cent of the final value of such trans-shipped goods are retained in national income, whereas for domestically produced goods the average is 60-70 per cent.[21] (See Figure 37.)

Figure 37: Trade value of exported goods by origin, 2011, € billions



Source: *Centraal Bureau voor de Statistiek.* Note: Value added of domestically produced exports is 60-70 per cent.

The challenge for the future then is to realign Dutch trade patterns towards the faster growing markets and reflect the new global economic realities. The question is whether this is best done within the European Union or outside.

Outside of the European Union, the Netherlands will be able to pursue trade agreements with high growth economies, as Switzerland has. In 2013 Switzerland became the first European country, and the first of the world's twenty largest economies, to establish a free trade agreement with China. After NExit, the Netherlands can re-negotiate agreements with countries where the European Union has existing trade relations. The Netherlands can work independently to: implement mutual agreements to remove tariff barriers; remove non-tariff barriers to trade; and remove the costs of adhering to European Union product standards. And, Dutch authorities can initiate negotiations on new free trade agreements with countries with which the European Union have not made a deal. (See Figure 38.)

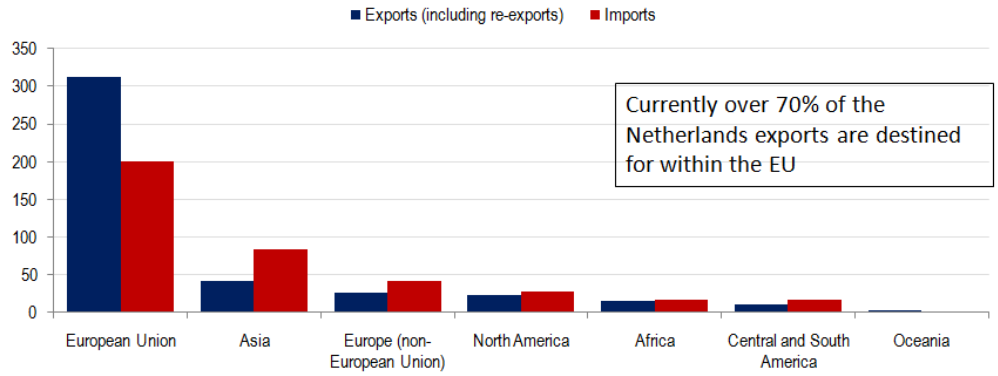
[21] Fred Kuypers, Arjan Lejour, Oscar Lemmers and Pascal Ramaekers, *Web magazine 07 February 2012* (*Centraal Bureau voor de Statistiek, Den Haag*), 2012

Figure 38: European Union trade arrangements with third party countries

Source: See European Commission press release for MEMO/13/282 (25/03/2013), at http://europa.eu/rapid/press-release_MEMO-13-282_en.htm (accessed 07-01-2014)

Clearly, any potential to expand trade with emerging faster growth economies needs to be kept in context. The European Union itself is and will remain a substantial market for Dutch exporters (and source of imports into the Netherlands), and any future benefit from improved exposure to non-European markets must be weighed against any detriment to existing trade with the bloc. (See Figure 39.)

Figure 39: Trade value of goods by region, 2012, € billions



Source: *Centraal Bureau voor de Statistiek*

But it is unclear there would be any. Why should trade with the European Union suffer after withdrawal from what is essentially a political structure? If the Netherlands were to retain its access to the internal market, there should not be any material detriment to trade with the European Union after NExit.

There are good reasons to believe that, after NExit, the Netherlands could continue to access the union's free trade area on current terms.

Not only is the European Union important to the Netherlands' trade position, Dutch markets are important to the rest of the European Union too. The Netherlands is one of the largest markets for exporters in a number of key European countries. Overall, it is the bloc's fifth biggest destination for exports. (See Figure 40 and Figure 41.)

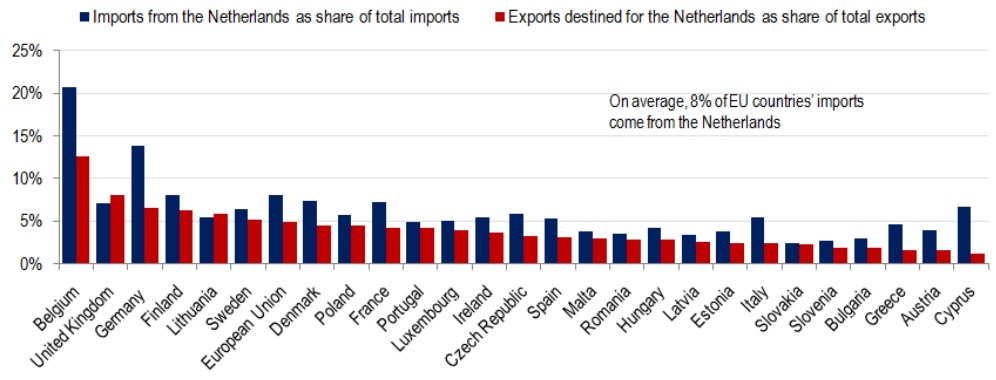
Given the scale of trade interdependence between the Netherlands and the European Union's members, there would be little to be gained on either side from hostile trade relations after NExit.

Figure 40: Top ten export destinations for selected European countries, share of total exports 2012

Belgium		Germany		France		EU	
Germany	(17.4%)	France	(9.4%)	Germany	(16.3%)	Germany	(13.1%)
France	(15.5%)	United States	(7.9%)	Belgium	(7.4%)	France	(8.1%)
Netherlands	(12.5%)	UK	(6.7%)	Italy	(7.3%)	United States	(6.5%)
UK	(7.1%)	Netherlands	(6.4%)	UK	(6.7%)	UK	(6.0%)
United States	(5.9%)	China	(6.1%)	Spain	(6.7%)	Netherlands	(4.8%)
Italy	(4.3%)	Austria	(5.2%)	United States	(6.1%)	Belgium	(4.8%)
Spain	(2.4%)	Italy	(5.1%)	Netherlands	(4.2%)	Italy	(4.5%)
India	(2.3%)	Switzerland	(4.4%)	China	(3.4%)	China	(3.2%)
China	(2.2%)	Belgium	(4.0%)	Switzerland	(3.1%)	Spain	(3.1%)
Luxembourg	(1.7%)	Poland	(3.8%)	Russia	(2.1%)	Switzerland	(3.0%)

Source: Eurostat. Note: These figures include re-exports.

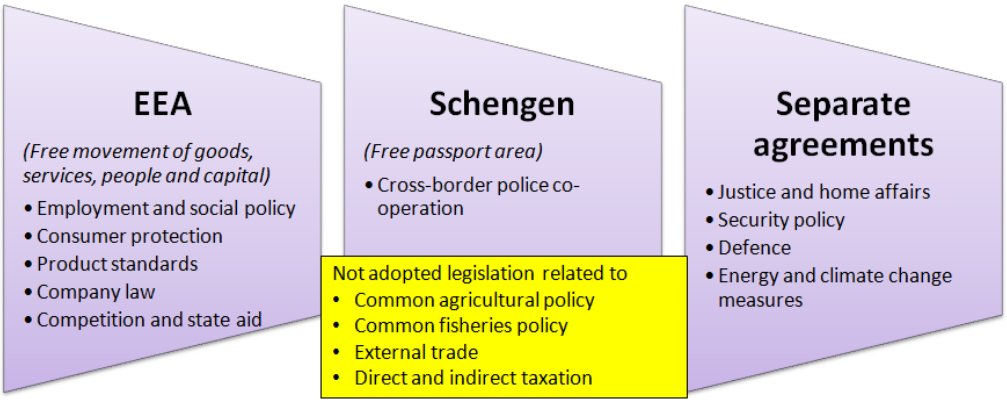
Figure 41: The importance of the Netherlands to European Union trade



Source: Eurostat

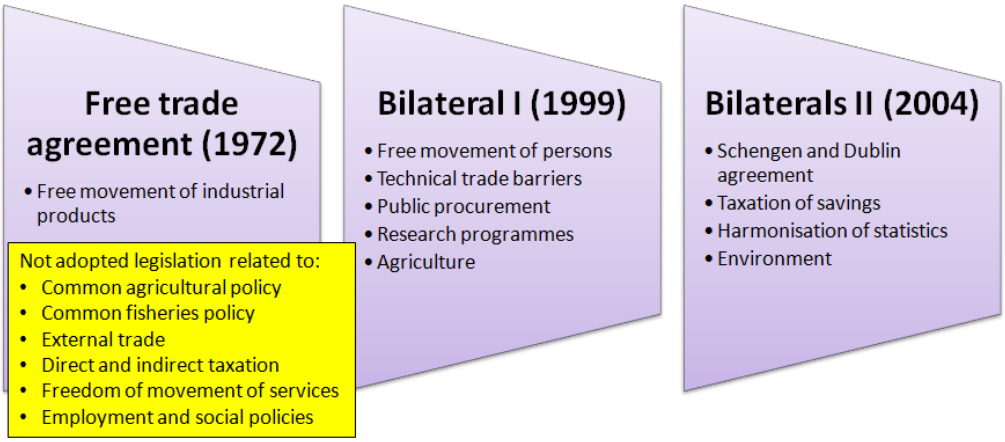
There is already a precedent for special trade relationships between the European Union and its close neighbours. Norway has access to the single market through its membership of the European Economic Area, while the Swiss, who are members of the European Free Trade Association but not the European Economic Area, have established free trading relations with the European Union through a series of bilateral agreements. Although their trade with the bloc is subject to Brussels' 'rules of origins' regulations, both countries have freedom to determine their own trade policy and arrangements with third party countries. (See Figure 42 and Figure 43.)

Figure 42: Summary of Norwegian arrangements with the European Union



Source: EEA Review Committee, *Outside and Inside: Norway's agreements with the EU (unofficial translation)* (General Secretariat of the Council of the European Union, Brussels), 2012.

Figure 43: Summary of Swiss arrangements with the European Union



Source: Integration Office FDFA/FDEA, *Bilateral agreements Switzerland*-EU (Integration Office FDFA/FDEA, Bern), 2009.

Given the links and dependencies both ways, a negotiated 'win-win' outcome where access to the internal market is retained and there is no detriment to trade in either direction is not only achievable but is, we believe, likely. Nevertheless, the process of NExit is unprecedented and uncertain, and myopic politics may get in the way of the best outcome. So it is prudent to consider other outcomes, even if they are less likely.

If withdrawal from the union results in expulsion from the single market, Dutch exports to the bloc are likely to become subject to tariffs, which will make them less competitive in their extant markets. As the Netherlands, the European Union and all of its other member states are members of the World Trade Organisation, the maximum tariff that could be imposed legally on Dutch exports by its neighbours are those specified under the 'most-favoured nation' rules.[22] Equally, these are the legal maximum that the Netherlands can impose on its imports from the bloc.

Taking account of the current mix of Dutch exports and imports, we calculate that applying the maximum tariffs permitted on European Union trade would increase the price of domestically produced exports to the union by an average of 6.6 per cent and re-exports by 0.3 per cent, while goods imported from the bloc would cost 5.2 per cent more on average. (See Table 9.)

Table 9: Impact of imposing maximum 'most favoured nation' tariffs on the price of goods traded between the Netherlands and the European Union

	Average MFN tariffs[1]	Share of 'domestic' exports to the EU	Share of 're-exports' to the EU	Share of imports from the EU
Food and live animals	15.3%	22%	13%	14%
Minerals	0.3%	14%	31%	16%
Chemicals	4.3%	19%	11%	12%
Plastic and rubber	4.3%	7%	4%	5%
Skins, fur and leather	3.1%	0%	0%	0%
Wood	1.6%	2%	2%	4%
Textiles and footwear	6.7%	2%	4%	3%
Stone and glass	3.0%	1%	1%	2%
Metals	2.1%	5%	11%	9%
Transport and machinery	2.6%	22%	22%	27%
Other manufactured products	1.9%	6%	1%	6%
Trade weighted tariff		**6.6%**	**4.0%**	**5.2%**

Source: Capital Economics calculations using International Trade Centre data. Note: The majority of the value of re-exports (92.5 per cent), which make up around 45 per cent of total exports, already have had the appropriate tariffs applied to them – so the change is much smaller.

We can use the findings of existing research to assess the impact of these price rises on export sales. Studies of the price elasticity of demand for exports and imports provide a range of estimates, but the calculations that follow are based upon price elasticities of -0.5 and -0.25 for exports and imports respectively, which are firmly within the range found in the literature as well as being conservative. (See Table 10.)

[22] World Trade Organisation, http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm (accessed 07-01-2014)

Table 10: Literature review of trade elasticities

Source	Coverage	Price elasticity of export volumes estimate
Jean Imbs and Isabelle Méjean, Trade Elasticities: A Final Report for the European Commission (DG ECFIN, European Economy – Economic papers – 432), 2010.	Germany, UK, France	-1.4 to -1.6
Task Force of the Monetary Policy Committee of the European System of Central Banks, Competitiveness and the export performance of the Euro area (European Central Bank, Frankfurt), 2005.	Netherlands	-0.35
Patrick Artus, Flash Economics-No. 215 (Natixis, Paris), 2013.	Netherlands	-0.5
Peter Hooper, Karen Johnson, and Jaime Marquez, Trade elasticities for the G7 countries (Princeton University, Princeton), 2000.	G7	-0.2 to -1.6
European Commission and the Kiel Institute of the World Economy	euro-zone	-0.25 to -0.35
Reasonable estimate based on existing literature		**-0.5**

Source: As indicated.

Overall, we estimate that the imposition of the maximum tariff regime will be relatively small. It will cost the Netherlands 2.6 per cent of its global exports, and the European Union 1.3 per cent of its exports to Dutch markets. (See Table 11.)

This calculated impact on Dutch exports takes account of:

- the effect of higher prices on exports to the European Union that are produced domestically
- the price effect on re-exports to the European Union. The majority of the value of re-exports, which make up almost half of total exports, will already have had the appropriate tariffs applied to them. The additional tariffs applied after NExit will have much less impact on the final price of the good
- 'rules of origin' regime. These rules will be applied once the Netherlands is outside the customs union. There is an administrative cost to implementing rules of origin which has been credibly and independently estimated at around three per cent of the value of transactions[23]

[23] Paul Brenton, *Rules of Origin in Free Trade Agreements* (The World Bank Group, Washington), 2013. p4

Table 11: Impact of external tariffs on imports and exports

	Change in price	Elasticity	Change in specified component of trade	Change in total EU trade	Change in total trade
External tariff on 'domestic' EU exports	+6.6%	-0.5	-3.3%	-1.8%	-1.4%
External tariff on 're-exports' to the EU[1]	+0.1%	-0.5	-0.1%	-0.1%	-0.1%
Rules of origin requirements on EU exports	+3%	-0.5	-1.5%	-1.5%	-1.1%
Exports					**-2.6%**
Imports from the EU	+5.2%	-0.25	-1.3%	-1.3%	-0.7%
Imports					**-0.7%**

Source: Capital Economics' analysis of TradeMap data
Note: The value added to re-exports in the Netherlands is just 7.5 per cent of total revenue of the export. As such, the calculations include an adjustment to the price change which reflects that only 7.5 per cent of the value of the good is subject to the new tariff.

The calculations above do not include any potential impacts on services. As it is, the single market in services is far less developed accounting for around 70 percent of European Union output, but only 22 per cent of intra-union trade.[24] There is not a set of common external tariffs for services, but rather a mixture of national and European legislation and regulation which act as non-tariff barriers for those wishing to trade within or externally to the European Union.

The European Services Directive aims to remove legal and administrative barriers to trade, covering around 45 per cent of European services.[25] The idea is that this will increase competition, lower prices and raise productivity. The European Commission's assessment in 2012 suggests that this has happened to some extent, with so far around 0.7 per cent added to the Netherlands' gross domestic product, although the costs of compliance with the directive are not included in the analysis. [26] Outside the European Union, or indeed the single market, the Netherlands could still benefit from gains of the services directive brought by standardisation of the administrative regimes in other European countries. So any negative impact on services is likely to be small.

Conclusion

The global economic order is changing markedly and forever. Future growth will come predominantly from the emerging markets of Asia, South America and, eventually, Africa. The challenge for the Netherlands, and for other European economies, is to realign themselves to take full advantage.

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24 All Parliamentary Party Group for European Reform, *Inquiry into the EU single market in services* (Open Europe, London), 2013

25 *ibid.*

26 Josefa Monteagudo, Aleksander Rutkowski and Dimitri Lorenzani, *The economic impact of the Services Directive: A first assessment following implementation* (European Commission, Brussels), 2012

The European Union as a whole has done a poor job of this. Outside the bloc, Dutch authorities have the opportunity to capitalise more fully on their country's international entrepreneurialism and tap into foreign growth currently eluding many Europeans.

Of course, the rest of the union will remain a vital trading partner for the Dutch; over 70 per cent of Dutch exports are destined for other member states. So, it would be foolish to damage Dutch businesses' prospects in European markets – but there is no reason to believe that NExit would do this. Given the level of trade inter-dependency between the Netherlands and other, especially northern, member states, and particularly the role of the Port of Rotterdam and Amsterdam Schipol airport as trade hubs, there is as much interest for, say, Germany in good trading relations with the Netherlands as *vice versa*.

It is completely possible (indeed, likely) that the Dutch could negotiate a Swiss or Norwegian style arrangement with the European Union whereby it retains the benefits of the single market, but is free to negotiate at will with countries beyond. This would be the best of both worlds. But even if this is not possible and, for whatever petty reasons, there is no negotiated exit and the Dutch become subject to the full force of European external tariffs, our calculations suggest that the impact on trade will not be that large and over time will still deliver economic benefits.

7 MACROECONOMIC POLICY

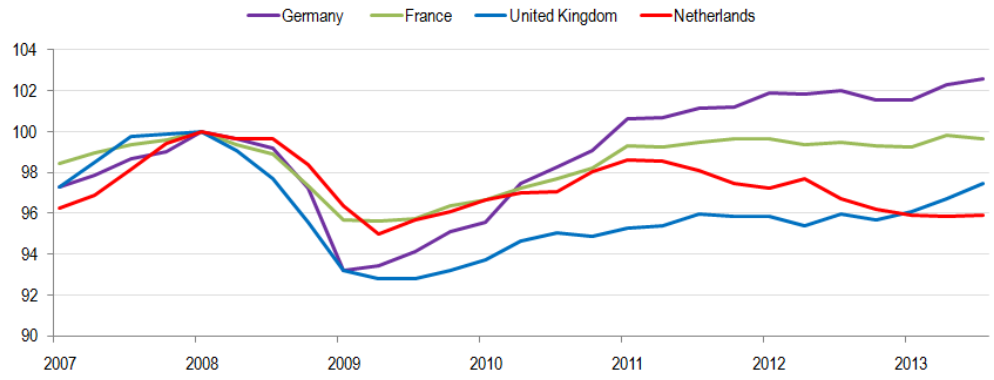
In this chapter, we consider a fifth benefit of NExit: the freedom for Dutch authorities to set their own macroeconomic policies to reflect their economy's needs.

The recovery in the Netherlands is proving weaker than in other core European countries.

Gross domestic product in the third quarter of 2013 was still 4.1 per cent below its high in the first quarter of 2008. Germany is now 2.6 per cent above of its pre-crisis high, and France has just recovered all its losses through the recession. Even the United Kingdom, which suffered acutely after 2008 given its exposure to financial services, is closer to recovering its pre-recession peak than the Netherlands. More concerning still, the Netherlands has seen national income continue to fall in many recent quarters while its northern European neighbours have grown (albeit slowly). (See Figure 44.)

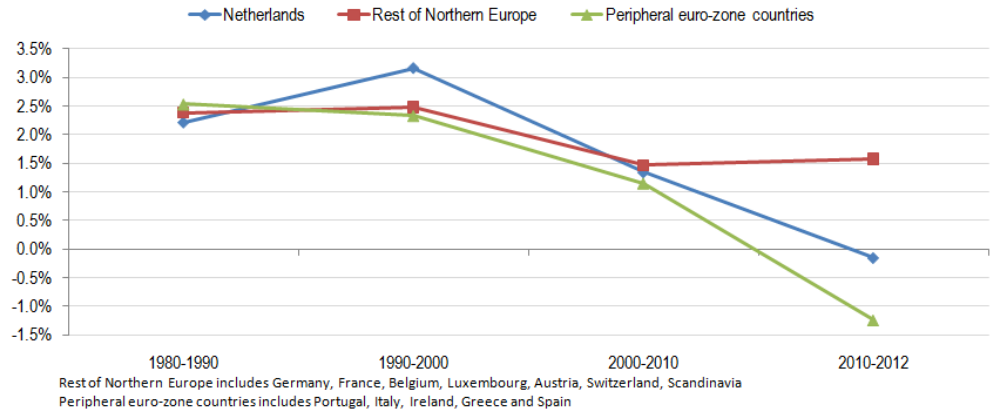
Whereas Dutch growth once matched or exceeded that across its northern European neighbours, recent performance makes the Netherlands look more like a euro-crisis country in the periphery than a 'core' euro-zone nation. (See Figure 45.)

Figure 44: Real gross domestic product (Q1 2008=100)



Source: Eurostat

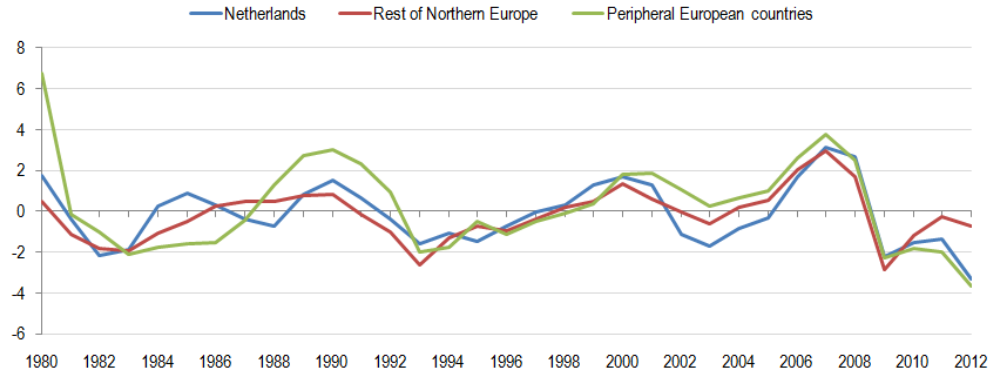
Figure 45: Average annual real growth in gross domestic product



Source: Capital Economics' calculations on International Monetary Fund *World Economic Outlook* database data

Although the Netherlands' business cycle has moved broadly in line with the rest of northern Europe up until the global economic crisis, since the euro's introduction the Dutch 'output gap' has often been larger. Currently, gross domestic product is estimated to be running at 3.2 per cent below its productive potential; in the rest of northern Europe, spare capacity is only 0.7 per cent. Monetary and fiscal management since 1999 has left more Dutch productive capacity redundant than typical for other 'core' euro-zone countries. (See Figure 46.)

Figure 46: Output gap as a percentage of potential gross domestic product



Source: Capital Economics' calculations on International Monetary Fund *World Economic Outlook* database data

As a member of the European single currency, Dutch monetary policy is now determined by the European Central Bank in Frankfurt, while fiscal policy is constrained by the stability and growth pact and associated rules – which are overseen by the European Commission in Brussels. With recent economic growth substantially below its northern European neighbours and a growing output gap, monetary policy set for the whole euro-zone has looked increasingly wrong for the circumstances in the Netherlands.

This should come as no surprise. European monetary union does not cover an 'optimal currency area'; monetary policy effectiveness would be enhanced if interest rates and other measures such as quantitative easing were set at a more local level.

There is an established literature that has developed well-regarded theories of optimal currency areas; these provide criteria for when a common currency should optimize economic efficiency (i.e. when it will lead to price and general economic stability).[27] They include: labour mobility; openness; wage and price flexibility; similarity in business cycles; and a risk sharing system. (See Table 12.)

Table 12: The three classic optimum currency area criteria

Source	Criterion
Peter Kenen, *The theory of optimum currency areas*, in Robert Mundell and Alexander Swoboda (eds) Monetary Problems of the International Economy (Chicago University Press, Chicago), 1969	**Production diversification** – countries whose production and exports are widely diversified and of similar structure form an optimum currency area
Ronald McKinnon, Optimum currency areas (American Economic Review, 53), 1962. pp 717-725	**Openness** – countries which are open to trade and trade heavily with each other form an optimum currency area
Robert Mundell, A theory of optimum currency areas (American Economic Review, 51), 1961. pp 657-665	**Labour mobility** - optimum currency areas are those within which people move easily

Source: Richard Baldwin and Charles Wyplosz, *The Economics of European Integration 3rd edition* (McGraw-Hill Education, Maidenhead), 2009. pp 314-349.

Prior to the inception of the euro the case was made many times, most notably by Barry Eichengreen in 1991, that Europe was not an optimal currency area or at least it was further from one than North America.[28] More recent research confirms that the optimal currency area criteria of labour mobility, wage flexibility, and fiscal and political integration remain far from being satisfied.[29] To a limited extent, that view has been counterbalanced by evidence of convergence in business cycles since the inception of the euro, although the finding of convergence is by no means consistent across all studies.[30] Even if convergence is admitted, it is not clear that much was gained by more

[27] For a more complete summary see: Richard Baldwin and Charles Wyplosz, *The Economics of European Integration 3rd edition* (McGraw-Hill Education, Maidenhead), 2009. pp 314-349.

[28] Barry Eichengreen, 'Is Europe an optimum currency area', *NBER Working Paper*, No. W3579, 1991.

[29] See Marjan Petreski, *Is the Euro Zone an Optimal Currency Area?* (School of Business Economics and Management, University of American College, Skopje), 2007.

[30] For example, see Jakob De Haan, Robert Inklaar, and Richard Jong-A-Ping, 'Will business cycles in the euro-area converge? A critical survey of empirical research', *Journal of Economic Surveys*, Vol. 22, Issue 2, 2008. pp. 234-273. Also see Domenico Giannone, Michele Lenza and Lucrezia Reichlin,'Business cycles in the euro area', *European Central Bank Working Paper Series*, No 1010, 2009.

advanced northern European countries from joining the euro; a pre-crisis paper by Stefan Krause of Emory University demonstrates that those countries that remained outside the euro would not have experienced a larger macroeconomic performance gain had they joined in 1999.[31]

But the strains on the euro-zone subsequent to the global financial crisis that began in 2008 are clear demonstration that the single currency area was not, is not and, without radical reform, cannot be an optimal union.

Interest rates and inflation in the peripheral European countries did move demonstrably closer to those of the core countries prior to the recent crisis. Despite this there were persistent and large differences in output gaps and inflation. As a result, with just one nominal interest rate across all countries, many euro-zone countries in the build up to the recent crisis had inappropriately low real interest rates, which led to large house price and other asset price bubbles.[32] Given the European Central Bank mandate of targeting price stability in the euro-zone as a whole and given that the euro area countries have structural differences in inflation rates, the build up of imbalances was inevitable. In the end, rather than providing economic stability, the monetary union has exacerbated the national boom and bust cycle and stripped away national stabilisers, and left nations unable to deal with disturbances.[33] Whilst it has to be remembered that countries with independent monetary policy, like the United Kingdom, did not avoid the recent boom and bust, their policy freedom has allowed them to respond to their particular circumstances.

There is a general consensus that, for the euro to work in the future, significantly deeper integration will be required to prevent the build-up of toxic imbalances. That includes giving pan-European institutions powers to raise taxes and/or pool national debt.[34] Given the real issues for national governments' sovereignty that this entails, as well as the potential for moral hazard by peripheral states, there is little appetite politically for either as it stands.

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[31] Stefan Krause, *Better Off without the euro? Evaluating Monetary Policy and macroeconomic Performance for Denmark, Sweden and the UK* (Department of Economics, Emory University, Atlanta), 2008

[32] See Christian Soegaard, *Macroeconomic policy in the EU: Monetary policy in the Euro-zone* (Warwick University, Warwick) 2013 at http://www2.warwick.ac.uk/fac/soc/economics/current/modules/ec307/details/ec307_monetary_policy_in_the_eurozone.pdf (accessed 07-01-2014)

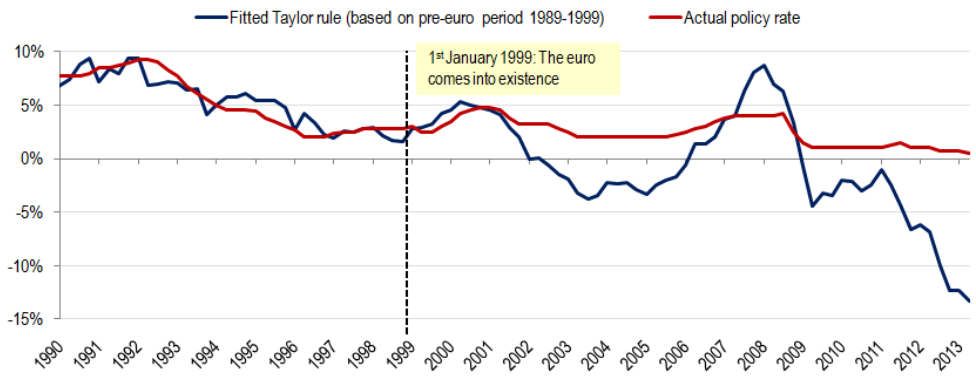
[33] See Paul De Grauwe, 'Design Failures in the Eurozone: Can they be fixed?', *LEQS Paper*, No. 57/2013, 2013.

[34] *ibid.*

Moreover, it is unclear that monetary policy is even being set for the benefit of the euro-zone as a whole. Tests by academics on the difference between actual and optimal interest rates suggest that European Central Bank policy is set more for the benefit of Germany rather than for the entire bloc.[35]

Certainly, the rates set by the European Central Bank are not those that might have been expected under the preceding *De Nederlandsche Bank* regime. Using the 'Taylor rule', we have estimated an equation that simulates how central bankers in Amsterdam responded with interest rate decisions to changes in inflation and the output gap over the period from 1989 to the introduction of the euro in 1999.[36] Applying this equation to data for the period from 1999 provides an indication of how a national central bank might have responded to the Netherlands' euro period economic performance. There is a marked difference between what the European Central Bank has done and what we estimate rate-setters at *De Nederlandsche Bank* would have done. Under the euro regime, rates have been tighter for most of the last decade but were looser in the build up to the crisis. In the most recent years, we might have expected Amsterdam to have cut rates faster and further than Frankfurt, and to have engaged in substantial monetary loosening in addition to rate cuts through the likes of quantitative easing. (See Figure 47.)

Figure 47: Taylor rule for the Netherlands based on Dutch central bank policy between 1989 and 1999



Source: Capital Economics' analysis of Eurostat data

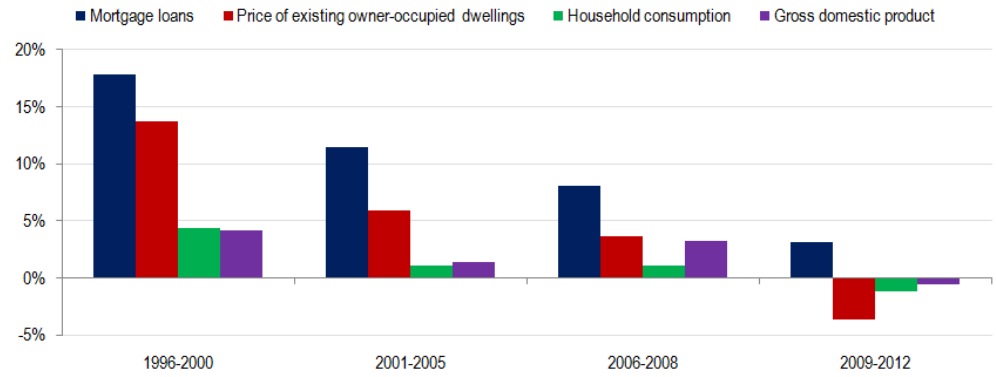
Some may argue that looser rates in the 2000s, as proposed above, would have been folly; household debt levels and home prices were rising unsustainably, and they might contend lower interest rates would have added further fuel to this fire. We disagree. Although the trends in debt and property values are

[35] See Gebhard Flaig and Timo Wollmershaeuser, 'Does the euro-zone diverge? A stress indicator for analyzing trends and cycles in real GDP and inflation', *CESifo Working Paper Series*, No. 1937, 2007

[36] For more information on Taylor rules see: John Taylor, 'Discretion versus policy rules in practice', *Carnegie-Rochester Conference Series on Public Policy*, Vol. 39, Issue 1, 1993. pp 195-214

undeniable, these were supported more by government house purchase incentives than any supposedly overly cheap borrowing rates. Indeed, over the decade, growth in consumers' expenditure was weak (and has now collapsed) – which points to the European Central Bank's monetary policy being too tight then, and would have only compounded the problem of growing debt levels. (See Figure 48.)

Figure 48: Average annual growth in mortgage loans, house prices, consumption and gross domestic product



Source: Ministry of Finance, *Effective Action Report* (Ministry of Finance, *Den Haag*), 2013.

Furthermore, we can apply the Taylor rule approach to estimate what the European Central Bank itself would do if it were setting interest rates for the Netherlands alone rather than the whole of the single currency area.[37] Although there is a better fit for much of the euro period so far, this analysis suggests that even Frankfurt's central bankers would be utilising extraordinary monetary measures to address the current Dutch economic climate. (See Figure 49.)

[37] The following equation is estimated, using monthly data:

$$i_t = \alpha_r r_t^* + \alpha_\pi (\pi_t - \pi_t^*) + \alpha_y (y_t - \bar{y}_t)$$

i_t = target base rate

r_t^* = assumed equilibrium interest rate

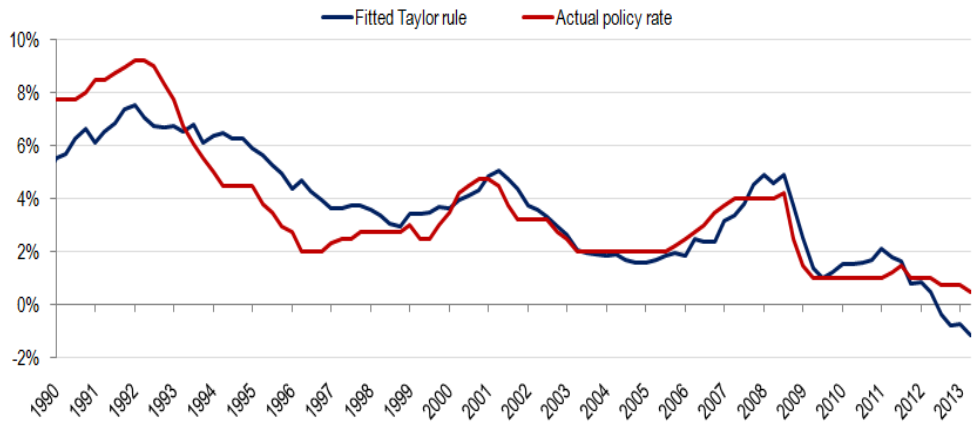
π_t = rate of inflation

π_t^* = target rate of inflation

y_t = output

$\bar{y}_t$ = potential output

Figure 49: Taylor rule for the Netherlands based on European Central Bank monetary policy since 1999



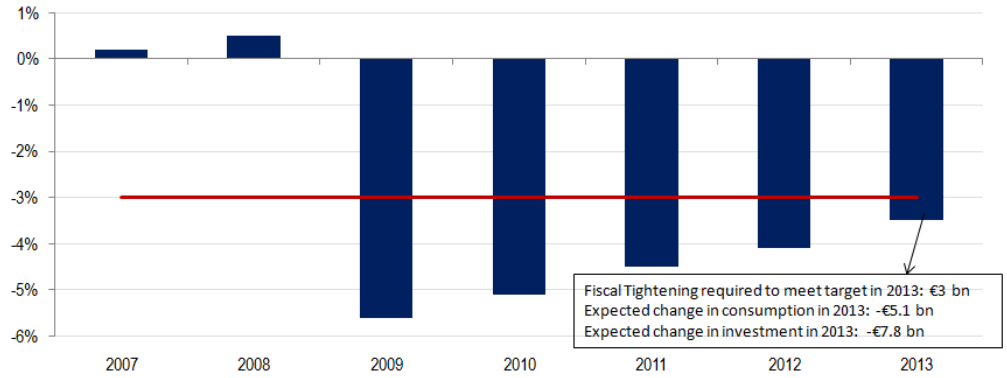
Source: Capital Economics' analysis of Eurostat data

Looking ahead, we can expect the mismatch between euro-zone monetary policy and Dutch economic conditions to slow any recovery. The Organisation for Economic Co-operation and Development predict the Dutch output gap to be bigger and longer lasting not only than in Germany but also in European nations outside the euro, who have monetary and fiscal independence.

NExit will also give the Dutch authorities greater freedom over fiscal policy, and allow them to use taxes and public spending to stimulate or deflate the economy. Inside the European Union, the Netherlands is tied to debt and deficit limits set out in the stability and growth pact.

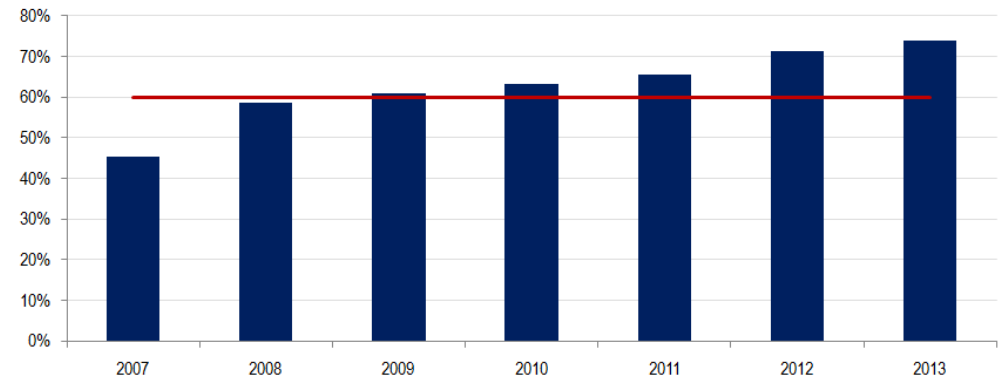
Following the global financial crisis of 2008, the Dutch public sector deficit and debts deteriorated sharply and breach the limits set in Brussels. The European Commission initially imposed a 2013 deadline (now extended to 2014) for the Dutch to reduce their deficit to three per cent of gross domestic product under the 'excessive deficit procedure'. (See Figure 50 and Figure 51.)

Figure 50: Budget balance as a share of gross domestic product



Source: Eurostat

Figure 51: Gross government debt as a share of gross domestic product



Source: Eurostat

Dutch authorities have responded with an aggressive austerity drive that is squeezing households through, for example, cuts to childcare subsidies and a two percentage point hike in value added tax.

Outside the European Union the Dutch would likely choose a more measured approach to deficit reduction. The Netherlands would still look to put debt back on a sustainable long term path, but the pace of cuts could be slowed compared to those demanded by Brussels.

There are good reasons to believe that this would be a sensible policy for the Dutch.

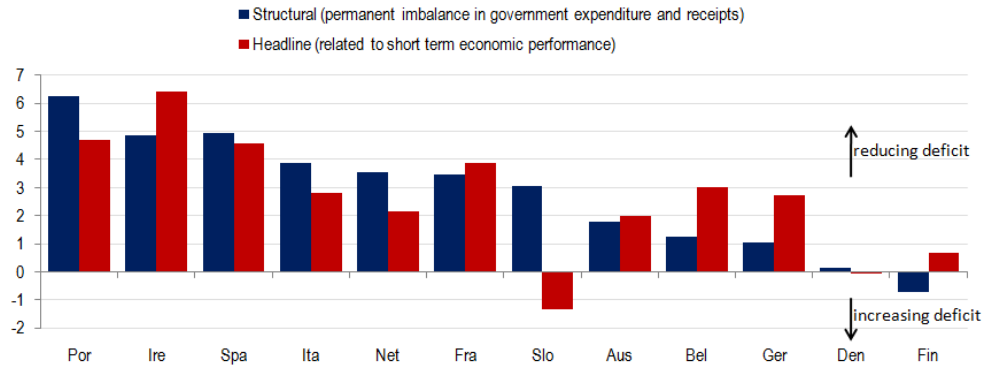
First, fiscal austerity is now widely understood as having a negative impact on growth in current conditions. The International Monetary Fund which was originally a strong advocate of rapid deficit reduction, demanding ambitious debt reduction commitments before issuing loans, has now admitted that the multiplier they used for government spending cuts in their earlier analysis was inappropriately small for a time of crisis.[38] Analysis by the *Centraal Planbureau* also makes the point that multipliers are higher in times of crisis and that cuts "should be implemented when unemployment is low".[39]

Second, the fiscal austerity measures haven't had the desired effects. Despite being pro-active in implementing austerity measures, the Netherlands has re-entered recession. Having implemented a structural tightening of 3.5 per cent of gross domestic product by the end of 2013, the headline deficit has fallen by only 2.2 per cent, representing one of the least effective fiscal consolidations in euro-zone. (See Figure 52.)

[38] Olivier Blanchard and Daniel Leigh, 'Growth Forecast Errors and Fiscal Multipliers', *IMF Working paper*, WP/13/1, 2013.

[39] Jasper Lukkezen and Coen Teulings, *A fiscal Taylor rule* (*Centraal Planbureau, Den Haag*), 2013.

Figure 52: Change in fiscal deficits 2009-13 (% GDP)



Source: Thomson Datastream

Third, there is little support for the latest austerity measures among the Dutch population. A July 2013 *Maurice de Hond* opinion poll shows that 50 per cent of the population believe no further cuts should be made and a further 30 per cent think less than the planned €6 billion would be a better option.[40]

And fourth, the international financial markets are not penalising Dutch authorities for their indebtedness. Despite the recent downgrade by the credit ratings agency Standard and Poor's, borrowing costs on the Netherlands' sovereign debt remain low. (See Chapter 10.)

Conclusion

Outside of the European Union, the Dutch government can regain control over monetary and fiscal policy, and set interest rates, taxes and public spending to address the specific needs of their stalling national economy. This will have near term benefits during the current economic crisis, and longer-term value as policy develops around the business cycle in the Netherlands and not in Germany.

The years since the inception of the euro have been disappointing for the Dutch economy (although this report does not comment on the causes of this). Consumption has slumped, households are highly leveraged and, although there are some signs of modest recovery, its progress is slow even against the tortoise-like performance of other member states.

This is not surprising. The Dutch malady is being treated using the prescription for a German patient. Unlike Germany (or at least what German authorities believe would be best for Germany), the Netherlands would benefit from looser monetary conditions (maybe a lower base rate, some

40 https://www.noties.nl/peil.nl/, (accessed 20-12-2013)

quantitative easing, slightly looser balance sheet requirements on banks, or a combination of some or all) while austerity measures are weakening domestic demand at the very time that Dutch businesses and consumers need to be spending. These issues can be better addressed with NExit and the macroeconomic policy freedoms it brings.

PART II: RISKS AND CONCERNS

Part II considers the economic risks and concerns associated with NExit.

The unravelling of 61 years of Dutch membership of the European Union and its predecessors (the European Coal and Steel Community, European Economic Community and European Community) is no small task, and it justifiably causes concern and has its own associated risks. But many of the concerns surrounding NExit can be addressed while many of the risks are overstated.

We examine six possible causes of economic risk or concern:

- ***Transition.*** **We consider the legal and practical issues relating to withdrawal from the European Union to confirm whether it is feasible and realistic policy**
- ***Currency.*** **We examine how the introduction of a national currency (which we call the new guilder) to replace the euro might affect business costs, and how its potential revaluation in foreign exchange markets might impact upon the macroeconomy**
- ***Sovereign debt.*** **We assess the potential for NExit to prompt a downgrading of the credit rating of Dutch public debt, and the consequences for cost of borrowing for government and business**
- ***Banking stability.*** **We consider the potential for NExit to cause instability in the Dutch banking system**
- ***Pensions.*** **We examine the extent to which NExit can further damage funding ratios for Dutch pension schemes**
- ***Inward investment.*** **We assess the potential impact of NExit on inward investment**

8 TRANSITION

In this chapter, we consider the feasibility of NExit from legal and practical perspectives.

NExit will be a significant economic, social and institutional event. Nevertheless, a smooth transition is legally, politically and practically feasible.

The departure of any member state would be an unprecedented and potentially complex event. Although Algeria left the European Economic Community in 1962 with its independence from France and Greenland voted to leave in 1985, a Dutch exit from the European Union would be an entirely different matter. Member states are now more closely integrated together and the bodies that function under the European Union umbrella have an ever widening reach. The Netherlands would also have to leave the common currency.

There are explicit rules set out in the treaties for European Union members who want to leave the bloc. Article 50 of the *Treaty on European Union* sets a time limit for the negotiation of a 'withdrawal agreement' between the exiting country and the remaining members. Such a withdrawal agreement might, for example, set out the trade relations after exit and the amounts of any ongoing contributions that the departing country may make to Brussels' coffers. Withdrawal agreement negotiations start once the Netherlands has informed the European Council of its intention to withdraw from the European Union in writing. The withdrawal agreement is negotiated by the Netherlands with a European Council approved negotiator who has been nominated by the European Commission.

A withdrawal agreement would set out the future relationship of the Netherlands with the European Union. This is not about whether the Netherlands should leave; this will happen regardless at the expiry of the negotiating deadline. Therefore any agreement has to align the interests of the Netherlands, otherwise the Netherlands would not agree to it, and also the interests of a qualified majority in the European Council.

Any proposed withdrawal agreement requires the consent of the European Parliament through absolute majority of votes cast (and Dutch members of the European parliament would be allowed to vote), and requires the remaining 27 member states in the European Council to approve the agreement through 'qualified majority voting'.

It would be churlish for any country to oppose an agreement simply to punish the Netherlands for exiting, but some may wish to make an example of the Dutch in order to deter other would-be leavers while others may see

opportunities for competitive advantage through imposing tariffs and other constraints on trade between the Netherlands and the European Union.

If agreement cannot be reached in two years, there is an option to extend the period of negotiation provided all sides agree. If not, the country exits the union then automatically, with the default position being a trade relationship based on World Trade Organisation rules (and, therefore, ejection from the internal market).

There are good reasons to believe that a mutually beneficial withdrawal agreement can be negotiated.

First, the scope of the agreement will be limited because some of the practicalities of NExit can, should and are likely to be conducted before the completion of any negotiation. In particular, urgent withdrawal from the single currency, and its associated institutions, will be needed to avoid potentially destabilising capital flows.

Our winning submission to the Wolfson Economics Prize 2012 argued for a swift departure from the single currency once the intention to leave the euro was announced[41] (albeit in the circumstances of a departing distressed indebted peripheral nation).[42] Announcing plans to leave the European Union is the same as it gives public knowledge of a future euro exit. An immediate departure from the currency avoids the potential for large capital flows, instability in the banking system and uncertainty about the nature of departure. This is in the interests of the euro-zone as much as (if not more than) the Netherlands, and as such it is likely that the euro-zone members will agree that the Netherlands exit the euro as soon as intention to withdraw from the European Union is announced.

Second, especially if a departure from the single currency is settled quickly, negotiations on the withdrawal agreement dissolves largely into bargaining the European Union-Netherlands trading relationship (and the extent of Dutch access to the single market) against the ongoing level of Dutch contribution to Brussels' coffers.

We have shown in Chapter 6 that the Netherlands' trade is as important to many European Union countries (especially the larger ones with greater influence) as access to the single market is to the Dutch. Regardless of any potential political sourness surrounding a NExit decision, the pragmatic and

41 Roger Bootle *et al*, *Leaving the euro: A practical guide* (Capital Economics, London), 2012.

42 In general, analysis of euro exit to date by us and others has focussed on the 'forced' exit of an indebted peripheral country, like Greece. There are important differences between a Greek-like scenario and the exit of a core northern country, but the mutual interest in urgency remains.

mutually beneficial way forward would be to retain free trade through continued access to the internal market. If the Dutch have decided to leave, a negotiated 'Swiss-like' bilateral agreement is a win-win for all sides.

There will be costs incurred by authorities, businesses and consumers in the Netherlands (and elsewhere) during transition – everything from diversion of civil service resource into negotiating exit through relocating, reassigning or making redundant European Union-linked offices and staff to reconfiguring funding regimes currently supported by Brussels. But the bulk of the transition burden is likely to result from the introduction of a replacement national currency to the euro, and the unravelling of Dutch integration in euro-zone institutions.

The costs of moving to a new currency will include: printing new bank notes and minting coins; legal expenses associated with the redenomination of contracts; updating payment systems and accounts; and updating and reprinting tariff cards, menus, etc. These are not trivial tasks but we can get a feel for their scale by examining the introduction of the euro as an example of a comparable exercise. Indeed, as part of their preparations for euro changeover, an internal survey among the euro area national central banks revealed that total costs of changing to the new currency were expected to be 0.3 to 0.8 per cent of gross domestic product.[43]

Conclusion

Any decision to leave the European Union should not be taken lightly. NExit will be a significant political, social as well as economic endeavour. But Article 50 provides the mechanism for the Netherlands to leave the union, while an immediate and urgent withdrawal from the euro will be desired by the whole bloc to avoid destabilising capital flows.

Although there will be come costs of the transition itself, especially in replacing the euro, a smooth NExit is legally, politically and practically feasible.

[43] Werner Dirschmid, Manfred Ruch and Ernest Gnan, *Economic Aspects of the Euro Cash Changeover in Austria*, in: Focus on Austria, 2/2001 (*Osterreichische Nationalbank*, Vienna), 2001. pp. 194-216.

9 CURRENCY

In this chapter, we consider the potential economic impact of the Netherlands replacing the euro with a new national currency, which for ease we call the new guilder.

With NExit, the Netherlands must replace the euro with a new national currency, which will reintroduce costs to businesses and households when conducting transactions across European borders. Meanwhile, as the new guilder is traded against other currencies, including the euro, its value will be set independently in the international exchange markets as it is used for trade, investment and speculation. Its value may go up, down or stay the same with consequent impacts on cross-border business, investment and assets, and the economy at large.

As preparation and justification for the introduction of the euro, a number of studies were conducted into the costs of currency transactions across Europe. One report published by the European Commission estimated that the costs of intra-European currency transactions before the euro were equivalent around 0.1 to 0.5 per cent of the bloc's gross domestic product, whereas another concluded they were in the range 0.3 to 0.4 per cent.[44] A report by a respected German economics institute put the value a little higher at 0.8 per cent.[45]

We need to be a careful when interpreting this material and applying it to NExit. In particular, these studies looked at the scale of impact across the whole euro-zone area – and not any specific country. The Netherlands is a much more open economy than is typical for euro-zone members; in 2012, exports were equivalent to 84 per cent of Dutch gross domestic product compared to an average of 45 per cent across the single currency.[46] Accordingly, currency transactions are likely to be more commonplace in Dutch business, with their expense being a greater share of overall costs. However, these pre-euro studies were considering the practicalities of transacting across seventeen separate national currencies. Under NExit, it will be simpler, and presumably less costly, with only two: the euro and the new guilder.

Turning to the potential for the new guilder to be revalued against the euro and other currencies, the issues here are more complex and need to be unpacked. In particular, there are likely to be different influences and

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44 Hugo Mendeziabal, *Monetary unions and the transaction cost savings of a single currency (*European Commission, Brussels), 1998 and European Commission, *One market, One money* (European Commission, Brussels), 1990.

45 IFO Institute, *Currency management costs* (IFO Institute, Munich), 1998.

46 Eurostat

outcomes depending upon the time period after NExit considered. Accordingly, we structure our analysis into three periods:

- Short-term: An initial period where the movement in the currency is driven largely by the attitudes and behaviours of speculative institutional investors and market-makers. This period is likely to be characterised by market volatility underpinned by investors' tendency to over-shoot

- Mid-term: Once the markets settle after their initial exuberance, we can expect to see the new guilder revalue to reflect the underlying trade, investment and competitiveness positions of the Netherlands. Through this period of 'structural revaluation', the new currency will appreciate or depreciate to unwind any mispricing of Dutch factors of production during the period of euro membership

- Long-term: Outside of the European Union, the Dutch will likely have a different economic trajectory – with different growth, inflation and interest rate prospects, which will be reflected eventually in a repositioning of currency exchange rates

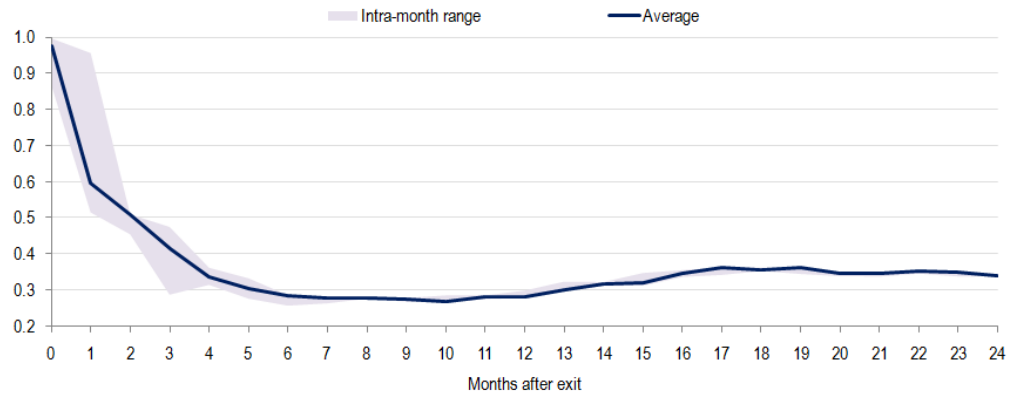
We consider each period in turn.

The history of major currency events shows that, in the short-term, authorities will need to be prepared for volatility on exchange markets in the initial months after establishing the new guilder.

An often cited example is that of the withdrawal of the dollar peg by Argentina in 2002. Then the peso was revalued by as much as 40 per cent between one day and the next and, despite the clear and predictable need for a downward revision for the currency, the initial path taken by markets was anything other than straight. (See Figure 53.)

But there are few, if any, parallels between Argentina in the early 2000s and the Netherlands now – and the then relationship between the peso and the United States dollar is very different to a future new guilder's to the euro.

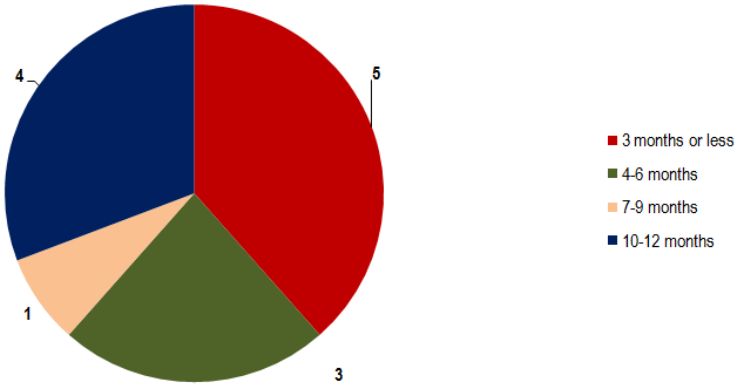
Figure 53: Dollars per Argentinean peso in two years following abandonment of the dollar peg



Source: Thomson Datastream

Any period of instability is, though, typically short-lived. Recent history of currency crises suggest that the international exchange markets largely stabilise and settle on the eventual level after around six months and no more than a year. (See Figure 54.)

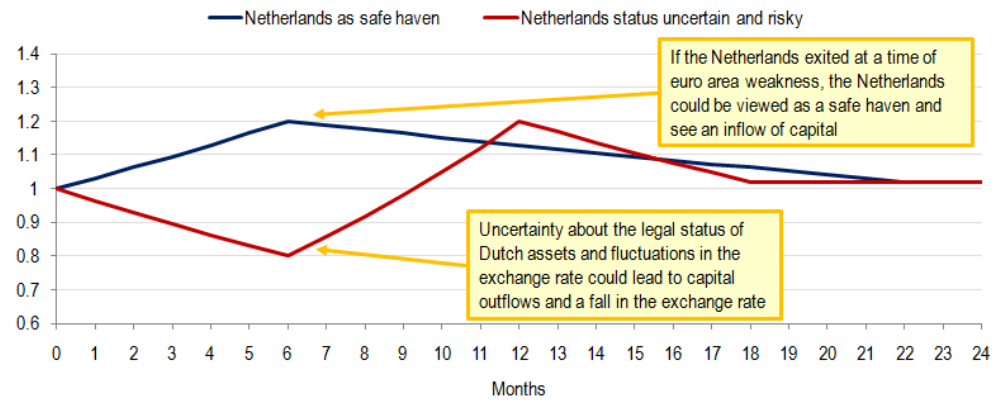
Figure 54: Major recent devaluations: number grouped by time from initial crisis to currency trough



Source: Mark Weisbrot and Rebecca Ray, *Latvia's Internal Devaluation: A Success Story?* (Centre for Economic and Policy Research, Washington), 2011

Most recent major currency events have often been in themselves the result of the local currency becoming overvalued, and have involved both initial volatility and devaluation. But this isn't the case for any Dutch withdrawal from the single currency. Indeed, there are as many reasons to believe the new guilder will be seen initially as a safe haven, especially if there remains no solution to the structural imbalances between core and peripheral nations, and appreciate against the euro, as there are to foresee the financial markets viewing the Netherlands as more risky and devaluing the currency. (See Figure 55.)

Figure 55: Stylised scenarios for euro–new guilder exchange rate after European Union exit



Source: Capital Economics

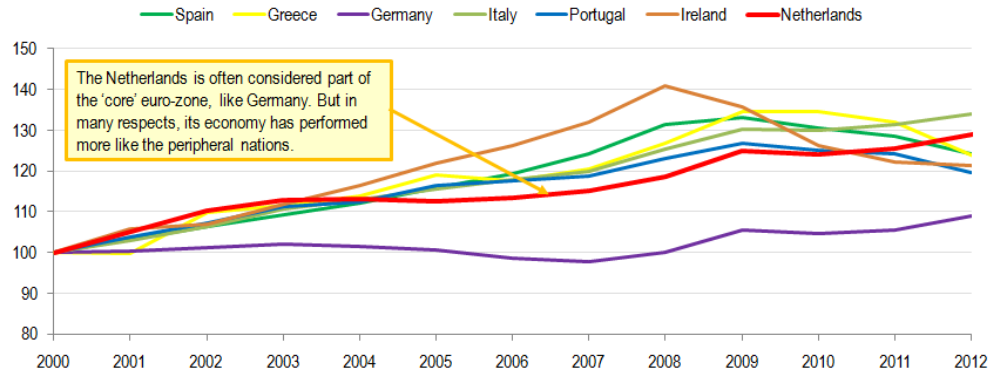
Meanwhile, investors may see the Netherlands as a safe haven from the dangers of euroland or NExit as a risky venture into dangerous uncharted waters. It is simply impossible to judge in advance how markets will react in the immediate period after NExit becomes public knowledge. The unexpected should be expected. Market volatility is the only certainty. But history provides little useful insight – as most major currency fractures have been forced upon authorities by markets. NExit will be the other way round.

Looking beyond any initial uncertainty and volatility, the mid-term value of the new guilder should rise or fall to unravel any structural mispricing of Dutch factors of production during the euro period.

It is often argued that the single currency has undervalued the 'core' euro-zone countries relative to those in the area's periphery, with wage restraint in the likes of Germany making Portugal, Italy, Ireland, Greece, Spain and others increasingly uncompetitive. If a peripheral country were to exit, markets would likely devalue their new currency, which would allow them to regain some international competitiveness without domestic deflation and nominal wage cuts. If a core country were to exit, an appreciation would be expected reflecting the otherwise accumulating surpluses created as increased competitiveness is not matched in salaries.

This analysis is true for Germany, where nominal wage rates have hardly risen since the euro's introduction, and is accurate for many of the indebted periphery too, where they have risen fast. But it is less clear whether it is appropriate for other northern European countries supposedly in the core. Indeed, it is not an accurate diagnosis for the Netherlands. (See Figure 56.)

Figure 56: Nominal unit labour costs (2000=100)



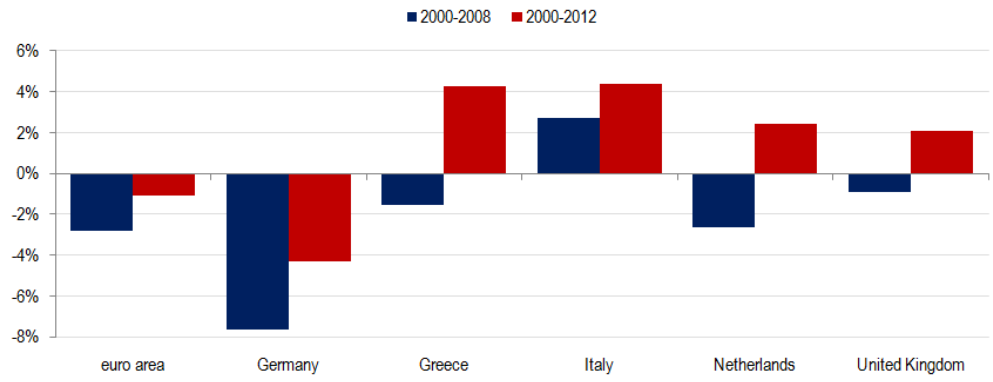
Source: Capital Economics' analysis of Eurostat data

Several measures of price, productivity and competitiveness performance since the introduction of the euro suggest a loss of Dutch competitiveness over the period, unlike in Germany, and challenge the view that the Netherlands is a 'core' undervalued euro-zone economy. Real unit labour costs did fall in the early years, but nowhere near as far as Germany's; and, more recently, they have risen. Nominal wages have risen faster than the euro-zone average. Dutch inflation has been around or above the euro-zone average. Real effective exchange rates have increased over the euro period rather than fall like in Germany. (See Figure 57.)

The Netherlands hasn't been a core country like Germany, and it doesn't appear to have been undervalued by the euro as Germany has.

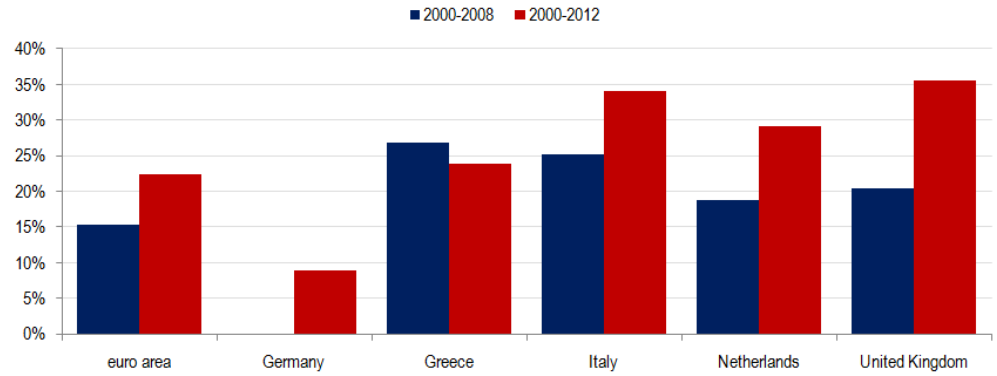
Figure 57: Various measures of changes in price, productivity and competitiveness over the period of the euro

(a) Change in real unit labour costs



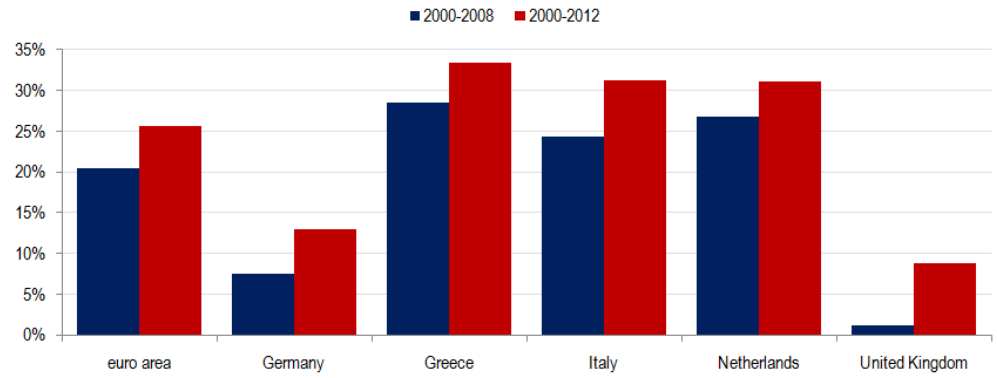
Source: Eurostat

(b) Change in nominal unit labour costs



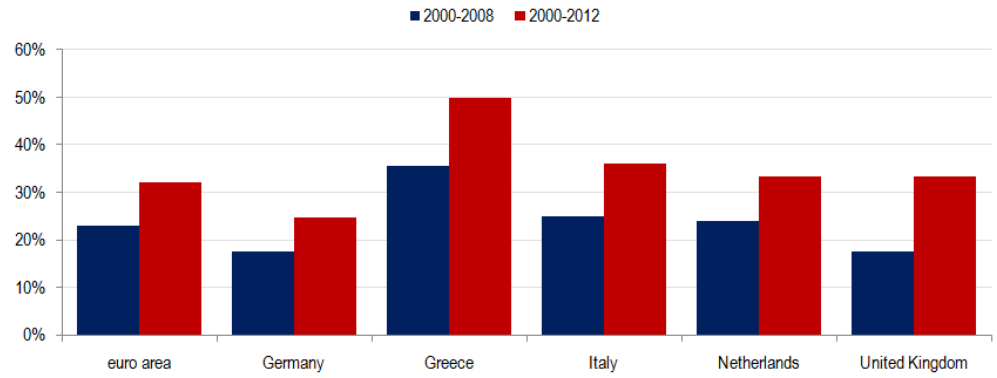
Source: Eurostat

(c) Change in gross domestic product deflator



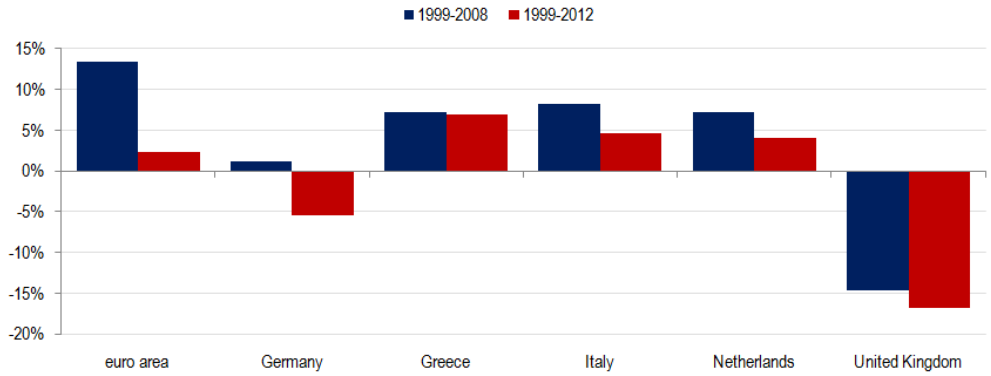
Source: Eurostat

(d) Change in harmonised consumer price index



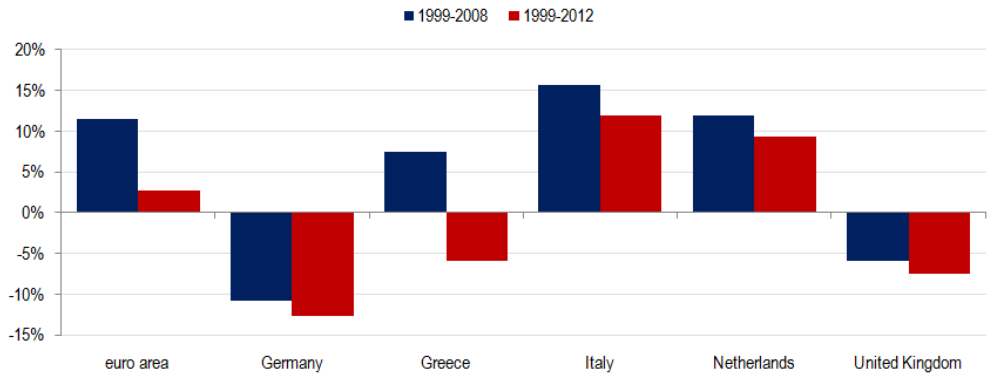
Source: Eurostat

(e) Change in real effective exchange rate (deflated by consumer price index)



Source: Eurostat

(f) Change in real effective exchange rate (deflated by unit labour costs)



Source: Eurostat

Of course, the Netherlands does have some 'core' characteristics.

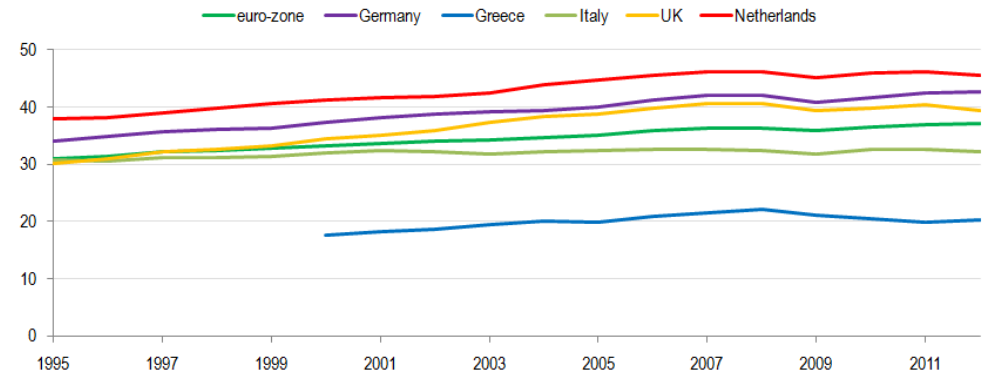
First, it has high labour productivity (although this is partly offset by high employee compensation relative to other euro-zone economies). This increased steadily from the inception of the euro until 2008, but has weakened through the crisis. (See Figure 58 and Figure 59.)

Second, the Dutch run a large trade surplus, like Germany — the Dutch current account surplus has averaged 7.6 per cent of gross domestic product since the first quarter of 2004, with the corresponding figure for Germany being 6.1 per cent[47] — although the 'terms of trade' indicate that their exports have become marginally less competitive over the period of the euro unlike Germany or the euro-zone average. (See Figure 60.)

47 Eurostat

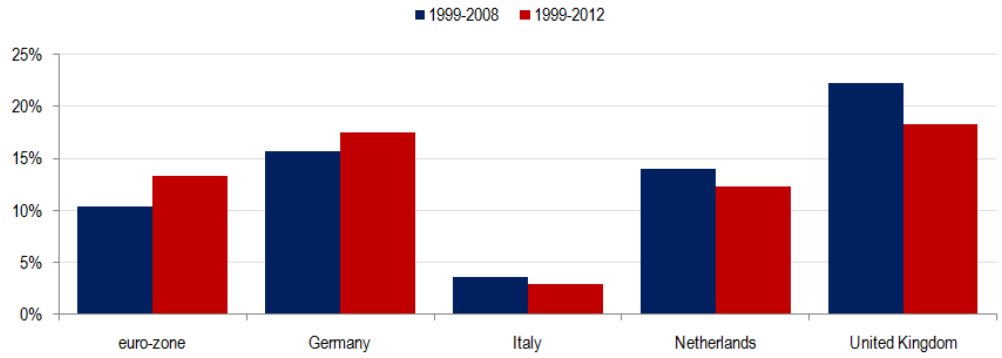
Figure 58: Measures of labour productivity

(a) Output per hour worked, euros (2005 prices)



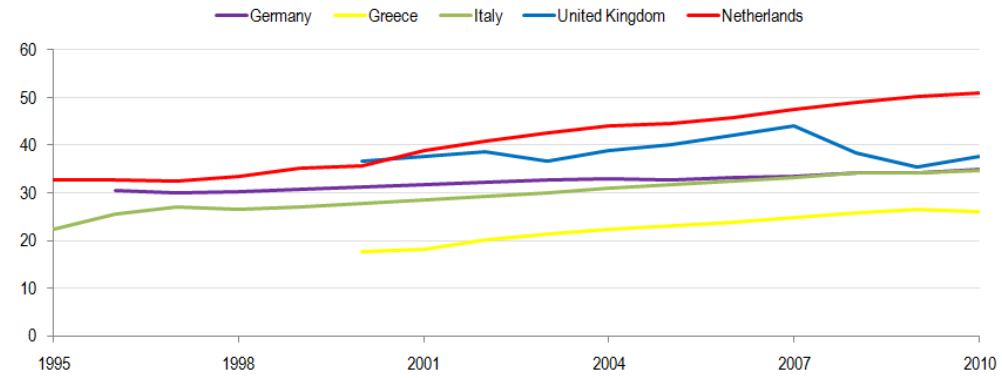
Source: Eurostat

(b) Change in real output per hour worked



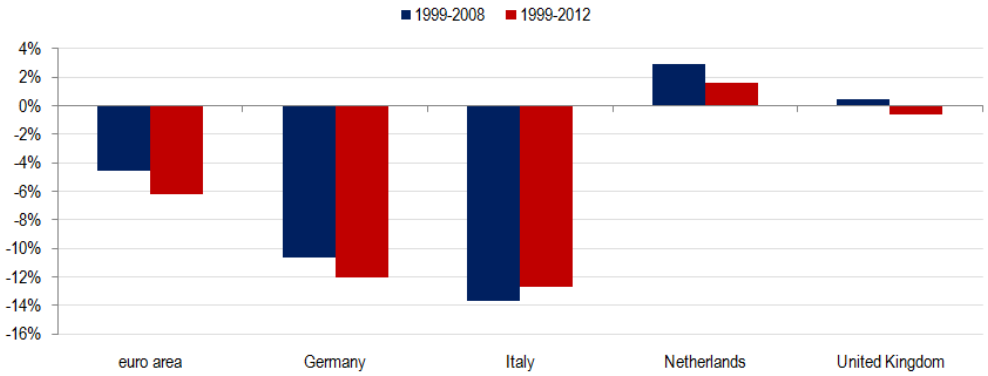
Source: Eurostat

Figure 59: Compensation per employee, € thousands per annum



Source: Eurostat

Figure 60: Change in terms of trade



Source: Eurostat

Overall, through the euro period, the Netherlands hasn't looked like an undervalued 'core' economy such as Germany, so a substantial appreciation of the new guilder isn't justified. But, there are reasons to believe that NExit won't prompt a material depreciation either.

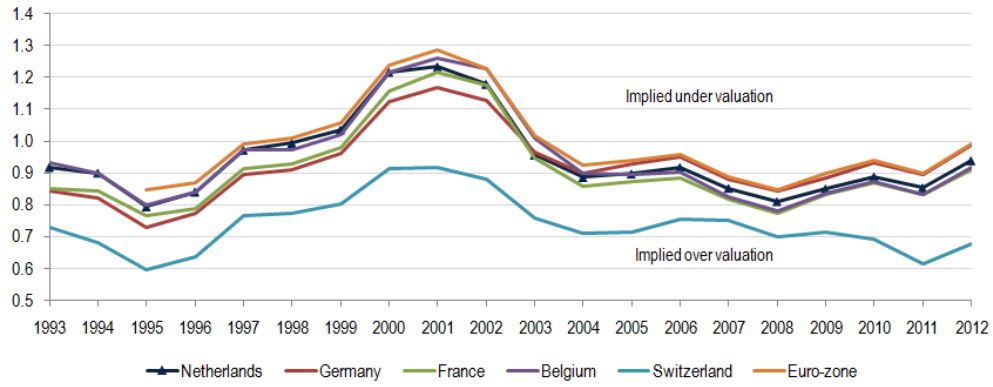
The original guilder was probably under-valued on entry to the euro. Analysis of real effective exchange rates by Charles Wyplosz suggests that the conversion rates adopted at the start of the euro implied an overvaluation for Germany and Austria, with undervaluations for other countries, including the Netherlands.[48] Indeed, in an interview published in the Dutch newspaper *Het Parool* in 2005, the director of the *De Nederlandsche Bank,* Jan Hendrick Brouwer, suggested that the guilder was undervalued by five to ten per cent against the *deutsche mark* when the two currencies joined the euro.[49]

Moreover, our interpretation is supported by purchasing power parity analysis. This suggests that the Netherlands is only slightly overvalued relative to Germany and undervalued relative to France and Belgium, suggesting any structural currency movements from a 'NExit' would be minimal. (See Figure 61.)

[48] See Charles Wyplosz, *Eurozone Crisis: It's About Demand, not Competitiveness*, at https://www.tcd.ie/Economics/assets/pdf/Not_competitiveness.pdf (accessed 08-01-2014)

[49] See Heather Stewart's article in *The Observer*, 'How long can the euro last?', Sunday 5 June 2005, at: http://www.theguardian.com/business/2005/jun/05/theeuro.europeanunion (accessed 07-01-2014)

Figure 61: Difference between nominal exchange rate ratio (national currency/US$) and purchasing power parity ratio (national currency/US$)



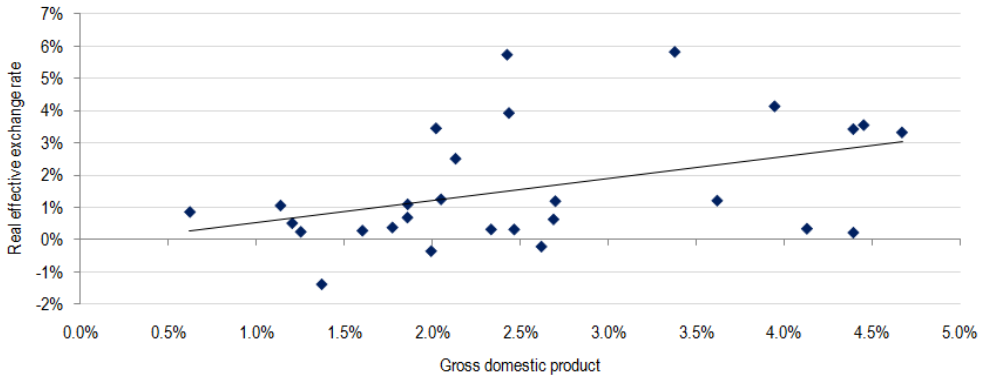
Source: Capital Economics' analysis on Organisation for Economic Co-operation and Development data.
Note: The purchasing power parity ratio indicates price levels relative to the United States. If this ratio is greater than the exchange rate (i.e. <1 on the chart) it implies that the same good could be bought more cheaply in the United states and so implies over-valuation of the currency relative to the dollar.

In the long term, the values of the new guilder and euro will diverge with their relative economic performances and their relative attractiveness to investors. After 'NExit', we expect the Dutch economy to grow faster than it would have otherwise done. This should lead to a longer-term real appreciation of the new guilder against the euro.

When a country grows strongly relative to its peers usually we expect its real effective exchange rate to appreciate. First, returns for investors are higher in a faster growing country leading to higher inward investment. Second, as productivity increases wages increase as well, even in sectors that are not becoming more productive and that will push up the price level. Even though a haircut is the same anywhere in the world, in more developed countries the price is higher because salons have to compete with other higher paying industries for workers. Hence the real exchange rate tends to appreciate if a country is growing relatively fast.

This positive relationship between gross domestic product growth and real effective exchange rate growth can be seen across 28 European countries. (See Figure 62.)

Figure 62: Average annual real growth in gross domestic product of European countries against average annual growth in real effective exchange rates, 1996-2008



Source: Eurostat

Conclusion

The introduction of the new guilder will increase the costs to businesses and households when they conduct transactions across European borders – but this additional burden is limited. Moreover, and potentially more importantly, a separate national currency can be revalued in international exchange markets, with potential consequential impacts on trade, investment and growth.

Initially, investors and currency speculators may see the Netherlands as a safe haven from the systemic dangers of an indebted and unbalanced euro-zone, and appreciate the new currency, or NExit as a risky venture into dangerous uncharted waters, and devalue it. It is simply impossible to judge in advance how markets will react in the immediate period after NExit becomes public knowledge. Unpredictable market volatility should be expected for around six months, and maybe for as long as a year.

But beyond the initial unpredictability, there is little to suggest any significant revaluation against the euro is needed in the medium term. The Netherlands is neither Greece nor Germany so we shouldn't expect the new guilder to be a *drachma* or a *deutsche mark*. The Netherlands shares some of the economic characteristics of Germany, especially its trade surplus, and some of those of the peripheral states, with high household indebtedness and weakening competitiveness. There are equally good arguments to suggest that depreciation is likely as appreciation. Neither can be ruled out. But overall, our analysis shows that there is unlikely to be a substantial revaluation of the new guilder either way.

In the longer-term, if we are right and the Netherlands' economy is better off out of the European Union, the new guilder should gently appreciate against

the euro as a result of higher growth and greater investor interest. This should also help to keep interest rates and borrowing costs relatively low.

10 SOVEREIGN DEBT

In this chapter, we consider the potential for NExit to impact on investors' perceptions of the risk of default on Dutch sovereign debt, and the implications that might have.

Beyond the currency markets, the sovereign debt markets may be influenced most by NExit. An event as exceptional as withdrawal from the European Union has the potential to create uncertainty in the minds of investors, speculators and businesspeople. They will reassess their views on future growth, inflation and risk, and the credit rating agencies that advise them will do likewise, which will all feed into their appetite for government debt.

In addition, NExit can have a direct impact on holders of Dutch bonds. As debt has been issued in euros to date, departure from the single currency adds a new risk for investors. First, the authorities must decide whether to honour their euro debts in that currency or redenominated them into new guilders. (There would be sizeable legal issues to address if redenomination was chosen, and such an action may be construed as *de facto* and/or *de jure* default.) Then, investors must face the consequences of potential movement in the value of the currency impacting on the return from the bonds they hold. Without redenomination, any depreciation in the new guilder will require Dutch authorities to spend more of their local currency in order to maintain the coupon payments at their fixed euro value. With redenomination, investors will see their returns fall as new guilder payments fail to meet the value of the originally euro denominated fixed payment. Conversely, without redenomination, any appreciation eases the debt interest burden of Dutch public finances – while, with redenomination, investors will benefit from a currency windfall as new guilder fixed coupons yield higher euro returns.

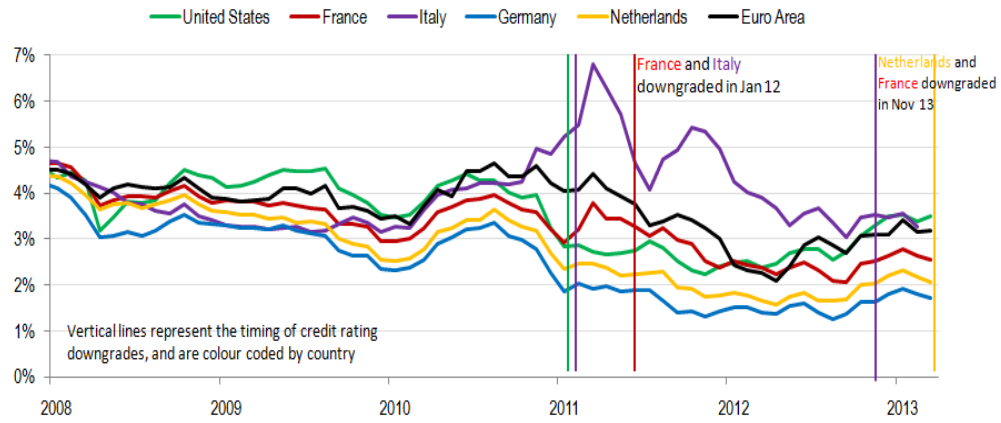
As we explain in Chapter 9, we do not anticipate that NExit will lead to either a material appreciation or depreciation – so the currency impact on bond returns should be minimal. Nevertheless, NExit changes the risks associated with holding Dutch debt and this can be expected to impact the market.

In particular, NExit may prompt credit rating agencies to downgrade Dutch bonds. We believe that any such decision by the likes of Moody's, Standard & Poor's and Fitch would be perverse (as we would argue growth prospects improve with exit while the Netherlands' becomes better isolated from further euro-zone crises) – but, sadly, such logic rarely persuades these agencies.

Nevertheless, a downgrade may not be a matter for serious concern. The numerous euro crisis downgrades, including the recent re-evaluation of the Netherlands by Standard & Poor's, have done little or nothing to worsen those countries' borrowing costs. Indeed, credit default spreads suggest that

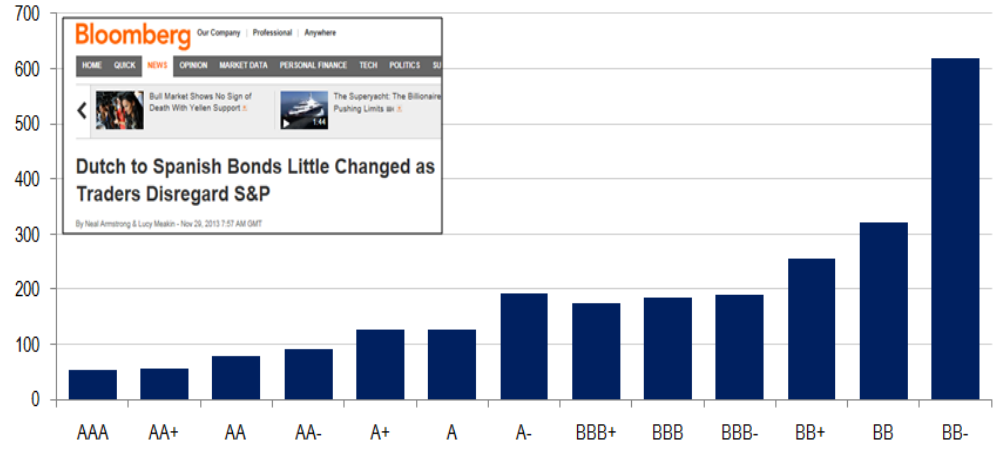
rating downgrades among the top tier borrowers, like the Netherlands, have little or no impact on their perceived riskiness. (See Figure 63 and Figure 64.)

Figure 63: Ten year government bond yield



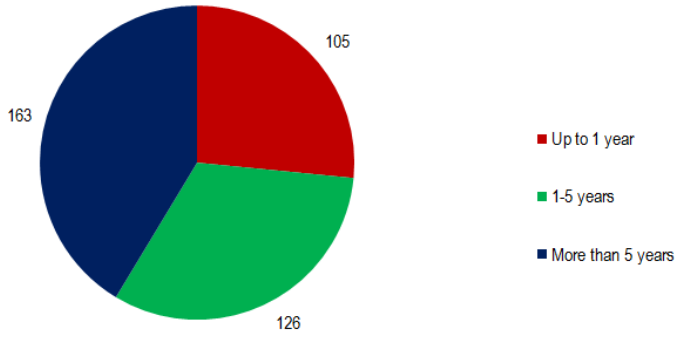
Thomson Datastream

Figure 64: Average credit default spread for ten year sovereign bonds in 2013 by credit rating



Source: Thomson Datastream, Trading Economics and Bloomberg. Note: Based on sample of 55 countries with no fewer than two in each category, credit ratings as of December 2013.

Figure 65: Residual maturity of state debt, 2011, € billions



Source: European Central Bank

Even if there was a downgrade and it lead to an increase in borrowing costs, the impact would still be muted given the maturity profile of Dutch state debt. On average, bonds currently have seven years to maturity on their current coupon values before they would have to be recycled with more expensive debt. (See Figure 65.) If there were a further downgrade to AA, the higher borrowing costs implied in Figure 64 would cost the government around €0.2 billion in the first year. If the downgrade and associated premium on borrowing persists, the annual cost would rise to over €0.4 billion by the fifth year.

Sovereign debt markets also influence companies' access to finance; it is, therefore, important to understand how NExit might impact upon the corporate bond market via any re-evaluation by sovereign investors and credit rating agencies.

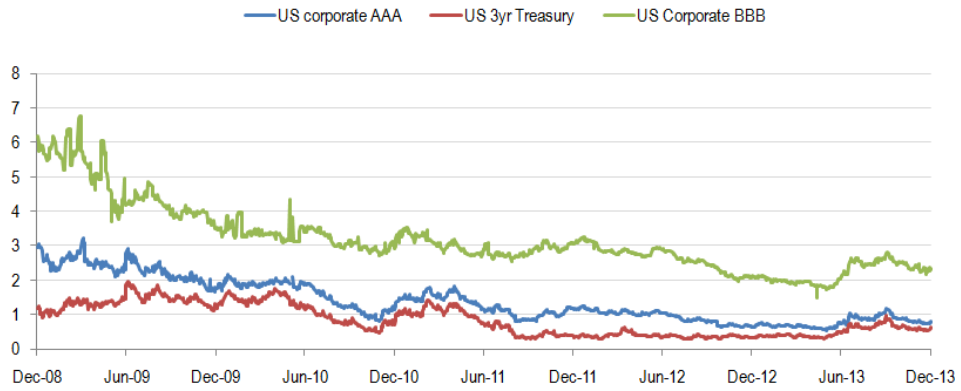
Although not binding, a country's sovereign debt rating generally acts as a ceiling for corporate credit ratings. Until 1997, credit ratings agencies never granted a credit rating higher than that issued to the sovereign. Since then that policy has been relaxed, albeit in practice by little. Sovereign and corporate debt ratings are also typically positively correlated (i.e. move in the same direction).[50]

Sovereign debt ratings also have an impact on corporate bond spreads, with lower ratings leading to higher spreads and hence higher debt costs for firms. However, during recent sovereign debt crises these spreads have narrowed. (See Figure 66.) Furthermore, recent examples suggest that there will be limited impact on corporate borrowing costs. The downgrade of the United Kingdom by Fitch in April of 2013 from AAA to AA+ had no noticeable

[50] For further evidence: Eduardo Borensztein, Kevin Cowan and Patricio Valenzuela, *Sovereign Ceilings "Lite"? The Impact of Sovereign Ratings on Corporate Ratings in Emerging Market Economies* (International Monetary Fund, Washington), 2007

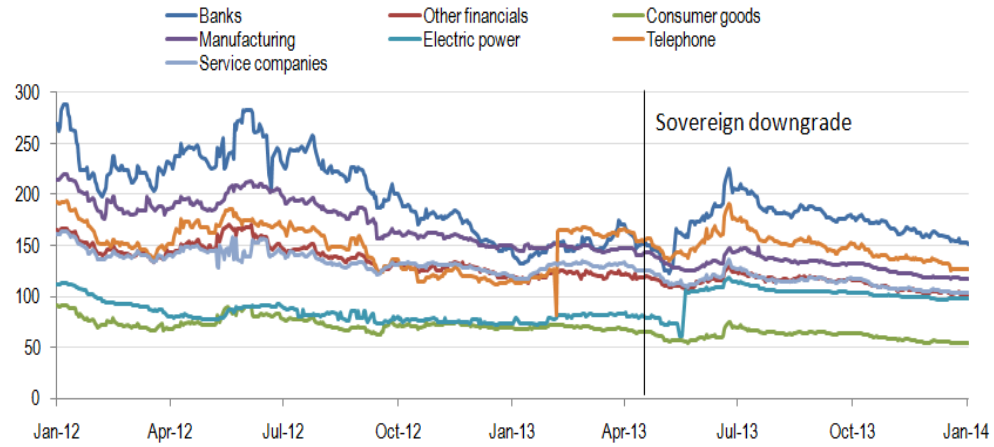
impact on credit default swap indices for the United Kingdom. (See Figure 67.)

Figure 66: Sovereign and corporate debt, redemption yield per cent



Source: Thomson Datastream

Figure 67: United Kingdom five year credit default swap spreads by sector, basis points



Source: Thomson Datastream

Conclusion

Although we believe that NExit will enhance prospects for the Dutch economy, we cannot presume that others, like the credit ratings agencies, will think the same. Indeed, withdrawal from the European Union may bring with it a further downgrade to the Netherlands' debt ratings.

But a downgrade isn't something to be feared greatly. It is unlikely to have a significant, if any, impact on borrowing rates. Rating downgrades among the top tiers have little or no impact on their perceived riskiness, and financial markets have hardly reacted to recent downgrades of European countries, including that of the Netherlands. Even in the unlikely event that a

downgrade results in higher costs of borrowing for the Dutch authorities, a large share of their extant debt is protected from interest rate increases in the short term as the average residual maturity is seven years.

There may be a knock-on impact on ratings and rates in the Dutch corporate bond market – but, even here, it appears that the markets have been willing to reduce spreads between sovereign and corporate rates since 2008.

11 BANKING STABILITY

In this chapter, we consider the potential for NExit to destabilise the Dutch banking sector, and in particular the impact of currency movements on banking balance sheets, the potential for deposit withdrawals and the implications of Dutch departure from the euro system for bank clearing.

The Dutch banking sector has a sizeable gap between deposits and its loan book domestically, which in part is funded through foreign liabilities. Downward swings in the exchange rate would damage their balance sheets and may lead to a shortage of liquidity. (See Figure 68.)

Figure 68: Aggregate balance sheet of Dutch monetary financial institutions, Q2 2013 € millions

Q2 2013			
Assets	**2,399,729**	**Liabilities & capital**	**2,399,729**
Loans	**1,346,294**	**Deposits**	**1,092,156**
Banks	203,944	Banks	157,532
Government	55,648	Central Government	10,310
Private sector	1,086,702	Non-central government and private	924,314
euro	*1,258,979*	*euro*	*1,028,774*
Securities	**327,080**	**Securities issued**	**471,571**
Banks	22,978	*euro*	*312,857*
Government	96,794		
Private sector	207,308		
euro	*318,825*		
Equities	**48,391**	**Capital and reserves**	**116,457**
Banks	17,126		
Private sector	31,265		
External assets	**394,537**	**External liabilities**	**421,667**
euro		*euro*	
Loans	*95,565*	*Deposits*	*137,380*
Securities	12,466		
Other (largely derivatives)	**283,427**	**Other (largely derivatives)**	**297,878**

Netherlands' banks have a significant funding gap

The banking sector has more external liabilities than assets

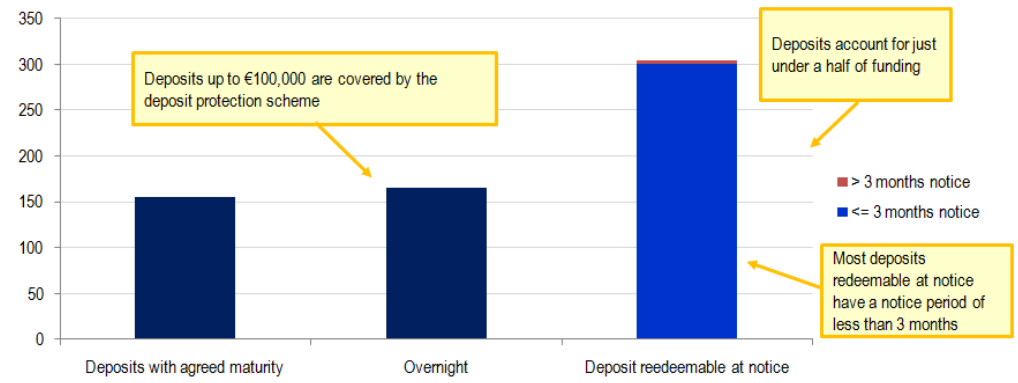
Source: *De Nederlandsche Bank*

We do not believe that a structural devaluation of the new guilder is likely and, therefore, there should be no medium term pressure on bank funding resulting from NExit or resulting impact on the broader economy. (We do, nevertheless, 'stress test' this analysis in Chapter 15.)

However initial currency volatility and weakness cannot be ruled out. Encouragingly, many deposits are sticky and most are covered by a generous deposit scheme. This means that there is little chance of NExit prompting withdrawals from Dutch banks, and even less scope for it to create wider instability in the banking sector and the economy at large. (See Figure 69.)

Moreover, in practice, *De Nederlandsche Bank* would be in a position to extend support to the banks and help minimise any disruption to the economy.

Figure 69: Deposits made by households and non-financial corporations broken down by instrument, Q2 2013 € billions

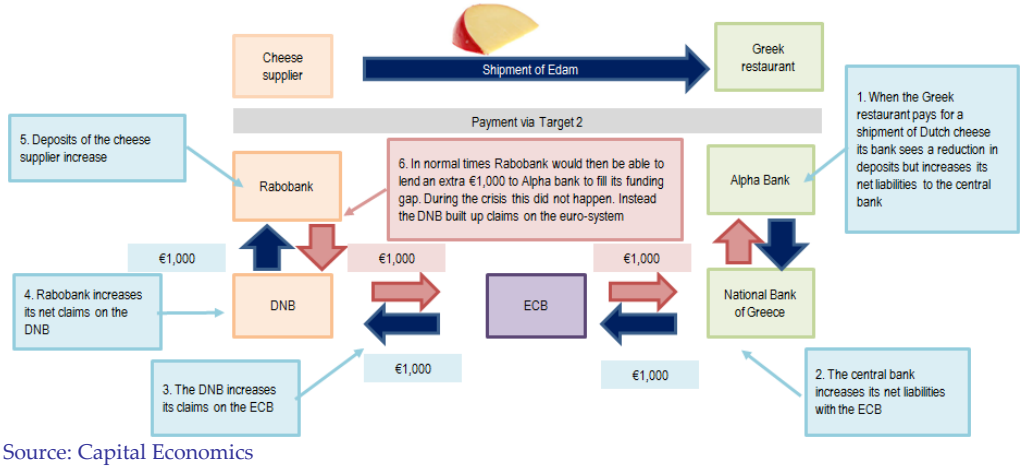


Source: *De Nederlandsche Bank*

With departure from the euro, the various Dutch positions in the euro system of payments and central banking will also need to be resolved, especially the outstanding surplus on the trans-European automated real-time gross settlement express transfer system (more commonly and easily called 'TARGET2').

TARGET2 settles and clears cross-border transactions within the euro-zone and, during the euro crises, significant imbalances have built whereby the core countries, including the Netherlands, have build up sizeable claims against the European Central Bank, while peripheral countries have grown their liabilities. (See Figure 70.)

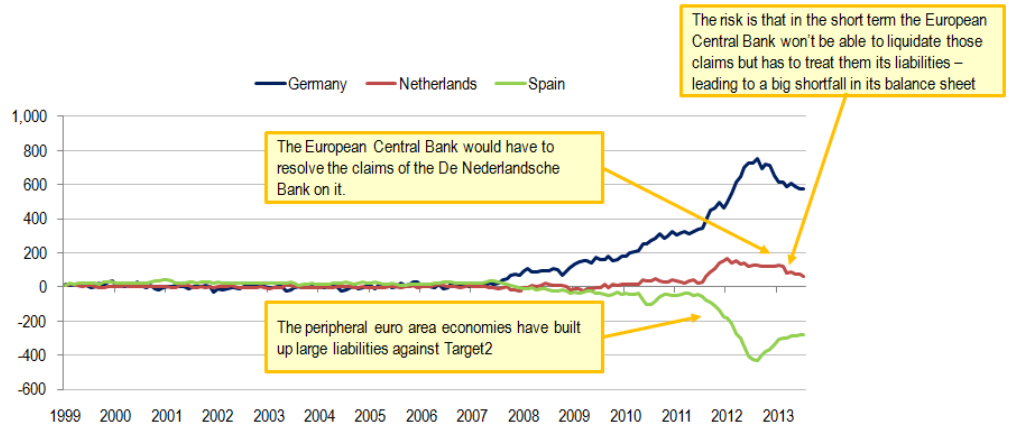
Figure 70: Stylised representation of how Dutch TARGET2 surpluses have developed



Source: Capital Economics

Resolution of TARGET2 surpluses adds an extra element of uncertainty to the banking sector; but it is an issue that can be dealt with. Furthermore the size of the claims that *De Nederlandsche Bank* has on the European Central Bank have fallen quite substantially since the peak of the euro crisis. (See Figure 71.)

Figure 71: Net balances with the euro-system, € billions



Source: Institute of Empirical Economic Research - Universität Osnabrück

Resolution would require an agreement between the euro-zone and Dutch central banks as to how claims would be honoured and in which currency. There are different ways in which TARGET2 creditor claims can be dealt with after NExit:

- *De Nederlandsche Bank* could remain a member of TARGET2 and maintain its surplus. However this would be dependent on future relations with the European Union; direct participation with maintenance of an own real-time gross settlement account is currently restricted to European Economic Area countries[51]

- *De Nederlandsche Bank* could make a complete exit from TARGET2 and claims on the European Central Bank could become part of their foreign exchange reserves. At the same time, the central bankers in Amsterdam exchange the previous euro deposits of its commercial banks with new Dutch money

The most practical and realistic solution appears to be for the TARGET2 balances to transfer to *De Nederlandsche Bank's* balance sheet as foreign reserves. As a large appreciation of the guilder will be unlikely, Dutch authorities would not be at risk of suffering a large loss. Furthermore converting claims into foreign reserves (i.e. euros) would demonstrate support and a belief that the euro would continue to exist as a future currency and that it would not break up further. This could help to minimise instability concerns and may help in the wider European Union exit negotiations.

[51] Willem Buiter and Ebrahim Rahbari, *Target2 Redux* (CEPR, London), 2012.

Meanwhile, the *De Nederlandsche Bank* has a €429 million capital share in the European Central Bank. There are several possible options to settle this claim:[52]

- *De Nederlandsche Bank* could buy back its capital share from the European Central Bank

- The remaining national central banks could purchase *De Nederlandsche Bank's* capital share. This has the advantage of keeping European Central Bank capital constant. Members would increase their holding of capital shares in proportion of existing weight in the capital subscribed

- *De Nederlandsche Bank* could retain its shares in the capital of the European Central Bank. All current European Union members participate in the European System of Central Banks and have capital shares in the European Central Bank. However, once the Netherlands has left the European Union, it may not be possible for them to remain a member of the European System of Central Banks. Hence this outcome would depend on a negotiated agreement allowing it

And the Netherlands has contributed €8 billion of the European Central Bank's foreign currency reserves:

- The European Central Bank returns reserves to *De Nederlandsche Bank*. But this decrease in reserves might require further contributions from remaining members

- The European Central Bank could retain the reserves and the resulting claim by *De Nederlandsche Bank* would be foreign reserves on its balance sheet. Dutch authorities would probably need to hold reserves denominated in euro anyway, so this would seem to be the most practical option

Conclusion

There is the potential for NExit to cause short term instability in the banking sector but, if it does, the impact is likely to be modest and short-lived.

Deposits in banks are covered by guarantees and the central bank would be in a position to provide short term funding to banks experiencing a severe crisis.

[52] For fuller details see: Eric Dor, 'Leaving the Euro Zone: A User's Guide', *ESEG Working Paper No. 2011-ECO-06*, 2011.

Meanwhile, TARGET2 imbalances can be resolved if *De Nederlandsche Bank* converts its claims into foreign exchange held at the European Central Bank.

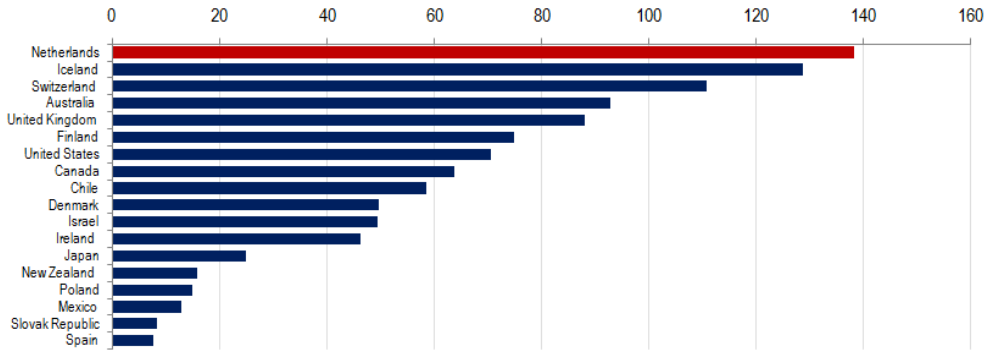
12 PENSIONS

In this chapter, we consider the potential impact of NExit on the Dutch private pensions system.

The Dutch hold substantial wealth in the form of pension funds, much of which is invested abroad. There could be concern that the value of these investments will be threatened especially if, after NExit, the new guilder appreciated.

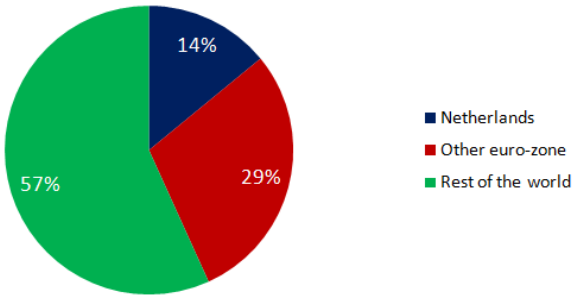
According to the Organisation for Economic Co-operation and Development, Dutch pension funds held assets worth equivalent to around 140 per cent of annual gross domestic product in 2011, which is more than any other member country.[53] With over 85 per cent of assets invested outside the Netherlands, any change in the new guilder after NExit will clearly have an impact on the sector's balance sheets. (See Figure 72 and Figure 73.)

Figure 72: Pension fund assets as a share of gross domestic product, 2011



Source: Organisation for Economic Co-operation and Development

Figure 73: Dutch pension funds' investments by location of asset, March 2013



Source: *De Nederlandsche Bank*

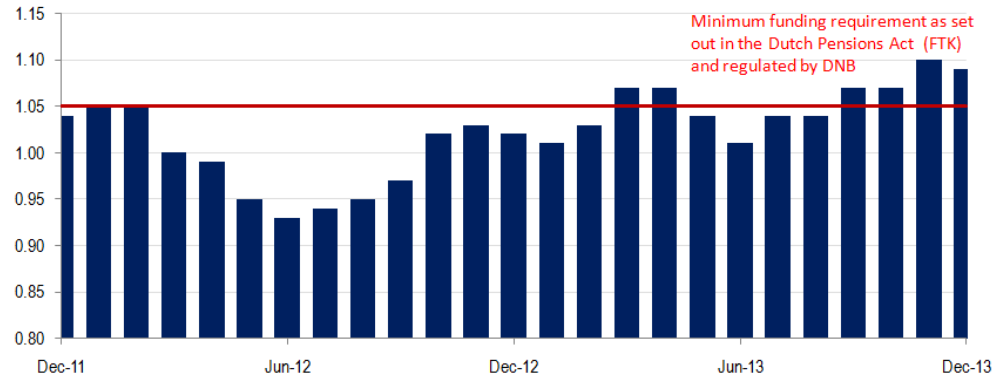
[53] Andre Laboul, *Pension Markets in Focus* (Organisation for Economic Co-operation and Development, Paris), 2012. p4

With low interest rates and an ageing population, pension funds are already struggling to meet their liabilities.

Pension funds are robustly regulated in the Netherlands and must maintain a minimum funding ratio of 105 per cent. If this threshold is breached they are required by the regulator to implement a recovery plan to restore the minimum funding ratio over a designated time period. Since the financial crisis, the time permitted to satisfy these conditions has increased from one to five years.[54]

Funding ratios dropped dramatically after the crisis and funds have faced a prolonged period of low interest rates. They have improved somewhat recently to 109 per cent, which is above the minimum funding ratio. (See Figure 74.)

Figure 74: Average funding ratio for Dutch pension funds



Source: Aon Hewitt
Note: This covers all pension funds – figures vary when looking at company, industry-wide or occupational funds individually

The fear may be that movements in the value of the new guilder subsequent to NExit could compound these difficulties. Any appreciation in the currency will weaken the new guilder return from existing foreign investments and further deteriorate pensions' funding. Equally, any depreciation will enhance foreign earnings in new guilder terms, so will flatter funding ratios.

As discussed in Chapter 9, after NExit it is likely that there will be a period of uncertainty and exchange rate volatility. This could go in either direction increasing or decreasing the value of pension funds' foreign assets. But any such period of volatility will likely ease within six to twelve months – and will not impact on the underlying funding position of pension funds. Pension funding is a longer-term structural concern, and regulators should not enforce corrective measures on funds that are suffering demonstrably temporary

54 Richard Wolf, *What's happening in.....the Netherlands?* (Allianz, Munich), 2012. pp 3-4

volatility created by external conditions outside of their control. Assuming that the funds remain financially solvent (which is likely or, in the worst case scenario, can be assured through short-term emergency intervention by authorities), there should be no impact on the real economy as any initial funding deficit will unwind itself once the uncertainty and volatility has passed.

More important will be the outcome of any medium term structural revaluation of the currency. Our analysis in Chapter 9 concludes that there will not be any significant revaluation of the new guilder in the medium term and, therefore, no material impact on pension funding. (For completeness and prudence, we have considered an alternative pessimistic scenario, which helps explore the potential downside risks even though we believe it to be unlikely. This stress test is presented in Chapter 15.)

Conclusion

The Dutch hold substantial wealth in the form of pension funds, and it is important to understand the consequences of NExit for these assets. By and large, the only significant way in which NExit might impact on pensions will be through any currency revaluation brought about by departure from the euro.

In the short term, any initial currency volatility should have no material impact on structures that are funded and regulated for much longer time horizons. However, any permanent appreciation of the new guilder will worsen pension funds' funding ratios while any depreciation will bring improvement. We do not believe a significant appreciation or depreciation is likely, so NExit will have little or no impact on the value of pension fund assets.

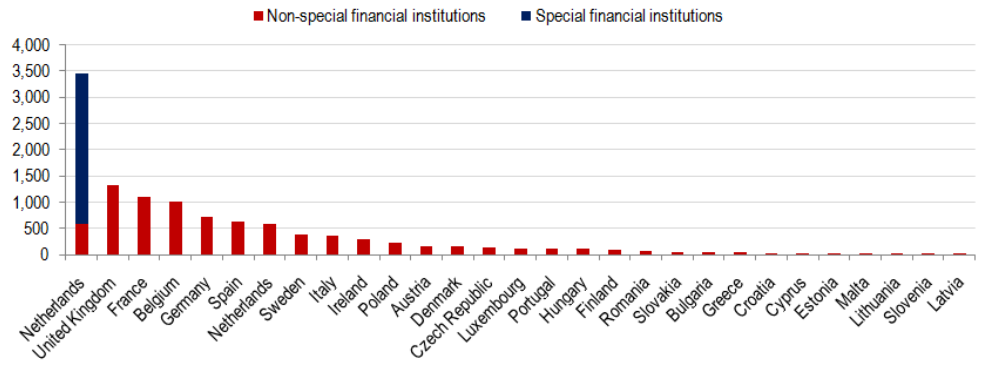
13 INWARD INVESTMENT

In this chapter we consider the impact of NExit on inward foreign direct investment.

The Netherlands is one of the European Union's top destinations for foreign direct investment and there could be concern that NExit will deter that investment, given the change in relationship with the European Union. However, we believe these fears are exaggerated. NExit may influence some current and would-be future investors, but Dutch attractiveness derives mostly from factors independent of European Union membership. Indeed, the Netherlands may be more attractive for certain types of investment out of the bloc.

The Netherlands is the leading destination for foreign direct investment among members of the European Union, although the bulk of the investment stock is held in so-called 'special financial institutions' which receive financial flows for onward investment elsewhere. (See Figure 75.)

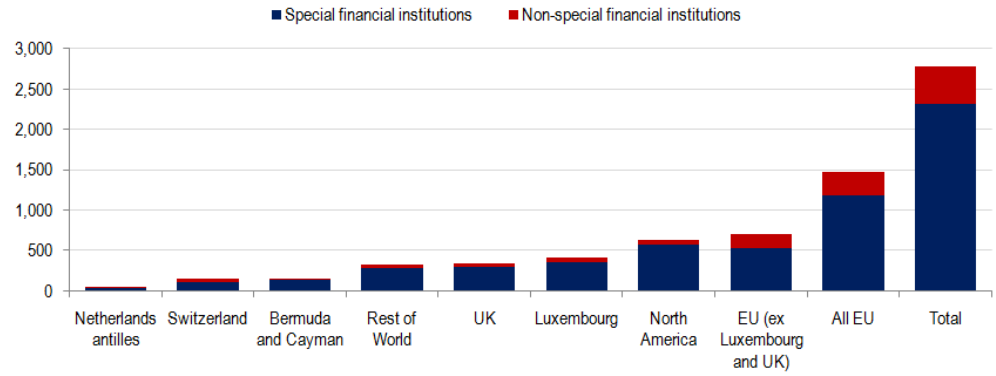
Figure 75: Inward foreign direct investment by country, 2012 US $ billions



Source: UNCTAD, *De Nederlandsche Bank*

The majority of the investment comes from European Union members, predominantly the United Kingdom and Luxembourg, who are likely to be intermediaries for others possibly outside the bloc; while a significant share of investment comes from North America. (See Figure 76.)

Figure 76: Stock of direct investment from abroad into the Netherlands, 2012, € billions



Source: *De Nederlandsche Bank*

Special financial institutions dominate the investment statistics. However, they are conduits for capital from one country to another, without any real investment in or return to the Netherlands; although their operations employ around 4,000 Dutch workers. Given that their existence is thanks to the tax treatment of foreign companies, an area in which the European Union has little influence, it is unclear why NExit should change the level of investment into these entities. (See Figure 77.)

Figure 77: Economic benefits to the Netherlands of the trust industry, 2008

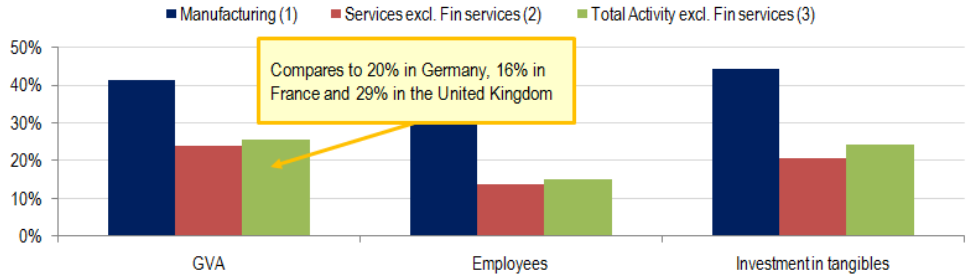
	Taxes	Value added	Employment
Legal entities	€1,195 m		
Trust offices	€57m	€242m	1,700
Additional services	€58m	€245m	1,300
Total	**€1,395 m**	**€487m**	**3,000**

Trust companies administer 75% of special financial institutions in the Netherlands, we uplift the statistics for the trust industry to give us the overall impact of 4,000 jobs.

Source: SEO Economic Research, *The Dutch Trust Industry: Facts & Figures* (SEO Economic Research, Amsterdam), 2008

However, the real concern for some is 'substantive' inward investment. Although the stocks of this type of investment seem pretty small in comparison to special financial institutions, 'substantive investment' into the Netherlands has a significant impact on the economy. Foreign owned firms account for fifteen per cent of employment in Dutch companies and 25 per cent of gross value added generated by the country's businesses. This is higher than its other northern European economies. (See Figure 78.)

Figure 78: Value added, jobs and investment in tangibles of inward investing multinational firms, proportion of Netherlands total, 2010



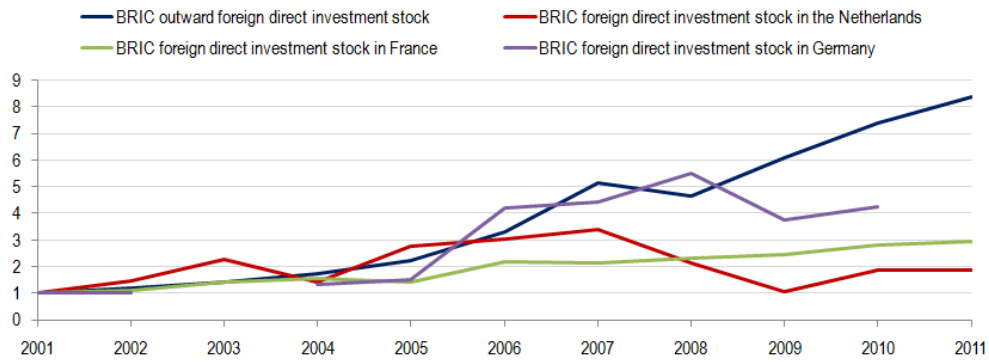
(1) Economic Activities (NACE Rev. 2) Group C : Manufacturing
(2) Economic Activities (NACE Rev. 2) G Wholesale and retail trade H Transportation and storage I Accommodation and food serving J Information and communication L Renting, buying, selling real estate M Other specialised business services N Renting and other business support
(3) Economic Activities (NACE Rev. 2) B Mining and quarrying C Manufacturing D Electricity and gas supply E Water supply and waste management F Construction G Wholesale and retail trade H Transportation and storage I Accommodation and food serving J Information and communication L Renting, buying, selling real estate M Other specialised business services N Renting and other business support

Source: Organisation for Economic Co-operation and Development

With uncertain and possibly poorer (or more costly) access to European markets, some may argue that NExit will threaten foreign direct investment. Indeed, analysis by the *Centraal Planbureau* suggests that, for the Netherlands, the share of the total amount of inward foreign direct investments stocks that can be explained by the single market was 18.5 per cent in 2005.[55] However, they note that this does not take into account possible substitution effects with other investments and could be upward biased.

But within the European Union now, the Netherlands is failing to maintain its share of investment from the emerging superpowers. Particularly since 2007, the Netherlands has failed to capture a significant share of the rapidly growing outward investment stock from Brazil, Russia, India and China. (See Figure 79.)

Figure 79: Total outward foreign direct investment stock of Brazil, Russia, India and China and their foreign direct investment in the Netherlands, France and Germany, Index 2001=1

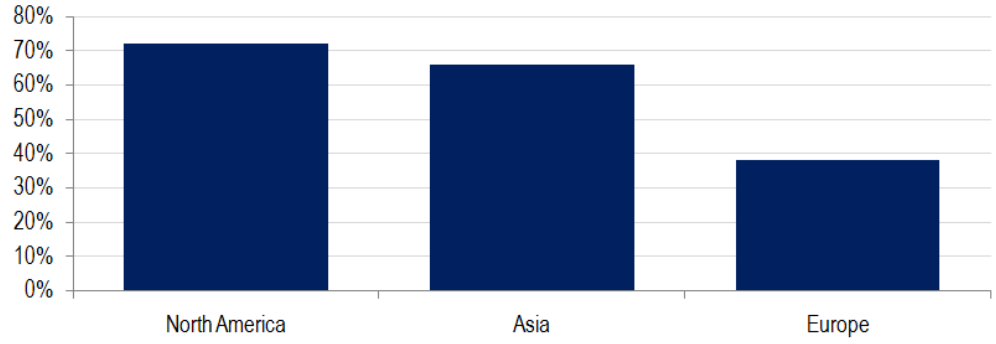


Source: United Nations conference on trade and development and Organisation for Economic Co-operation and Development

55 Bas Straathof, Gert-Jan Linders, Arjan Lejour and Jan Möhlmann, *The Internal Market and the Dutch Economy* (*Centraal Planbureau, Den Haag*), 2008.

Whilst undoubtedly the prolonged crisis in the euro-area is a factor (itself a result of euro-zone membership), recent evidence suggests that the institutions of the European Union could be contributing to lower investment levels from investors emerging markets. A survey of the United Kingdom's potential investors revealed that non-European investors do not see membership of the European Union as an advantage. (See Figure 80.)

Figure 80: Percentage answering 'Yes' to the question: If the United Kingdom renegotiated its relationship with the European Union to be less integrated than it is today, would this make the United Kingdom a more attractive place to invest?



Source: Ernst & Young, *Ernst & Young's attractiveness survey: UK 2013,* (Ernst & Young, London), 2013

On the other hand, for European investors, membership of the European Union appears to be important. And with around two thirds of foreign investment originating from within the European Union it is a genuine concern for the Netherlands. However, given that it is likely the Netherlands is likely to be able to negotiate access to the single market, the situation for European investors won't change much. The only difference being that that they will face potentially higher administrative burden for exports to the European Union, although this will counterbalanced to some extent by a more efficient regulatory regime.

Moreover, when we consider the qualities of the Netherlands that are important to inward investors, European and Non-European alike, we find that many of the attractions of the Netherlands are independent of membership of the European Union, and would remain strengths of the Dutch economy after NExit. This includes a sufficient supply of skilled labour, the stability of the investment environment and access to regional markets. (See Figure 81.)

Figure 81: World investment prospects survey results: Importance of a selection of factors for inward investors

	World	EU-15	EU-12
Size of local market	21	20	12
Growth of local market	20	12	19
Stable investment environment	10	19	12
Access to regional markets	10	11	7
Cheap labour	9	n.a	12
Availability of skilled labour	9	11	12
Access to natural resources	6	4	8
Access to capital market (finance)	2	6	2
Incentives, government effectiveness	5	11	6
Follow the leader	4	3	3
Total	100	100	100

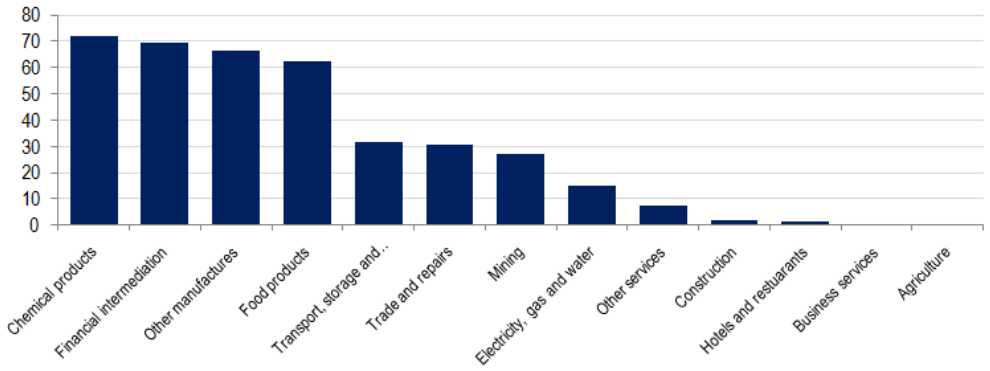
Note: The table provides the main location factors for attracting FDI for the period 2007-2009 in %.
Source: UNTCAD's World Investment Prospect Survey (2009).

Netherlands acts as a gateway to Europe, offering a highly skilled and multilingual workforce

Source: UNCTAD Research

This is particularly true of the chemicals products sector, the biggest recipient of foreign direct investment in the Netherlands. (See Figure 82.)

Figure 82: Foreign direct investment stock by broad sector, € billions 2011



Source: Organisation for Economic Co-operation and Development

Industry research suggests the key drivers of foreign direct investment in the chemical products sector are demand, the existence of clusters and innovation.[56] All of these would remain after NExit: western and central eastern Europe would still be the biggest consumers of chemical products, the agglomeration benefits and existing infrastructure of the chemicals clusters in the Netherlands would not be changed and the highly skilled workforce and top engineering institutions would still continue to provide top quality employees for foreign businesses.

In addition to retaining many of its attractions to foreign investors, outside the European Union the Netherlands would have more room in negotiating favourable investment treaties. These could be shaped to allow greater flexibility in demands for certain types of regulation, such as that concerning

[56] Edward Croufer, Pieter-JanMermans and Christian Weigel, *The Staying Power of Europe's Chemical Industry* (Arthur D. Little, Brussels), 2005.

the environment and could lower administrative burdens placed on foreign investing companies.

Conclusion

The Netherlands is among the European Union's top destination for foreign investment, both for redirection elsewhere and for domestic development. Although NExit may influence some investors, Dutch attractiveness is mostly independent of the European Union and may even increase.

Inward investment plays an important role in the Dutch economy. Firms choose the Netherlands for its location in Europe, its labour force, infrastructure and its existing clusters, all of which will remain after NExit. Although exit will impact on foreign firms investing to export to the rest of the European Union, these problems should be minimal if the Netherlands negotiates continued access to the internal market. What's more, with appropriate external trade and investment agreements the Netherlands could become a more attractive place to invest and NExit could bring tangible increases in gross domestic product.

PART III: THE PROSPECTS AFTER NEXIT

Part III provides a quantitative evaluation of the potential economic impact of NExit.

In order to systematically weigh up the pros and cons of NExit, we have cautiously estimated the impact of the various factors discussed in this report on future Dutch economic performance. Of course, economics is not a precise science and there are margins of error and uncertainties. But throughout, we have taken what we believe to be a realistic but cautious approach.

We describe the assumptions we have made relating to each of the various impact of NExit. We then draw them together to assess the overall benefit (or otherwise) withdrawal from the European Union, and test the robustness of our results to varying assumptions.

14 ASSESSING THE IMPACTS

In this chapter, we start our quantitative evaluation of NExit and, in particular, we outline the assumptions we have made regarding the various potential impacts of withdrawal from the European Union on the Dutch macroeconomy.

We consider the potential material benefits and risks of NExit discussed in Part I and Part II, and for each of them estimate the possible scale of their impacts on Dutch economic performance over the coming decades.

This exercise shouldn't be read as trying to provide specific predictions. Economics is not a precise science. Rather, it is a way to understand the impact of NExit in the round, systematically and consistently assess the pros and cons, and produce a robust and meaningful conclusion regarding the merits or otherwise of European Union withdrawal. Throughout, we have taken what we believe to be a realistic but cautious approach.

14.1 Methodology

In the remainder of this chapter, we explain our estimates of the benefits and costs of the various impacts of NExit. But there are some issues of methodology that relate to some or all of the impacts that are more efficiently dealt with first.

In our modelling of the overall impacts of NExit, we consider three scenarios for the Netherland's future relationship with the European Union: 'EFTA + bilaterals', which assumes a trade relationship similar to that of Switzerland and the union; 'EEA', which is akin to the Norwegian relationship; and 'WTO', which assumes that no withdrawal agreement is reached. Some of the potential impacts of NExit are the same for all three scenarios, while others vary considerably. Where necessary this section explains the differences between the calculations for each scenario.

For each impact of NExit, we estimate its macroeconomic effect in terms of how it might change future levels of Dutch gross domestic product. The relationships between specific impacts (for example reductions in government expenditure) and macroeconomic performance are complex. Depending on their nature and timing, some first round impacts can be expected to stimulate the macroeconomic circle of incomes, expenditures and output by far more than their initial value; whereas others may achieve an impact on gross domestic product far less than their original magnitude, if their value is leaked out of the domestic economy or it crowds out domestic activity that

would have otherwise happened. These 'multiplier effects' have been included in our assessments where appropriate (although we have also tested the sensitivity of our overall results to these assumptions).

For some impacts we have also had to consider how any savings in government expenditures might be used in the future. First, they are used to ensure that government debt falls at a rate which is sustainable. In each of our scenarios the government's debt to gross domestic product ratio is lower by the end of the period than what would happen otherwise if the Netherlands remains in the European Union. Thereafter, savings are used to provide a fiscal stimulus through either government expenditure in the Netherlands or cuts in taxation.

14.2 Public finances

After NExit, the Dutch government would no longer have to make its current contributions to the European Union budget and would therefore be able to make substantial annual savings in public expenditure.

The Netherlands is a net contributor to the European Union budget; the Dutch hand over more money to Brussels than they receive as part of Europe-wide expenditure programmes. With NExit some or all of this leakage of Dutch national income to foreign countries can be stopped. The precise amount that can be saved will depend upon the withdrawal agreement; any ongoing access to the internal market is likely to have its price – just as Switzerland and Norway contribute to the European Union now. Our calculations are set out in the table. (See Table 13.)

Moreover, the current levels of contribution are suppressed through the temporary arrangements relating to the United Kingdom's rebate. As things stand at the time of writing, there is non-binding political consensus to maintain these arrangements until 2020. In our calculations, we assume that the consensus holds and that the Netherlands continues to pay reduced contributions until 2020. Thereafter the additional cost rises from €0.7 billion initially to €0.9 billion in 2035 (in today's prices).

In addition, there is the potential to make savings in the current €2.1 billion per annum of public expenditure in the Netherlands that are delivered under the auspices of the European Union although are funded entirely by Dutch taxpayers (e.g. the common agricultural policy). Savings are likely both from improving the efficiency of programmes that are retained after NExit and through cutting programmes that do not meet domestic political or economic needs. It is not our place to make essentially political judgements about where

any cuts may be made; instead, we use a conservative estimate of a twenty per cent average reduction.

Table 13: Calculating the potential savings to be made through reduced contributions to European Union budget under different scenarios

	2012		2017-2020	2021-2035
	Percentage of gross national income	€ billion	Percentage of gross national income	Percentage of gross national income
(A) Netherlands gross contributions	1.11	6.7	1.11	1.11
(B) *Less* rebate	0.10	0.6	0.10	0.00
(C) *Less* EU spending in Netherlands	0.35	2.1	0.28	0.28
(D) *Equals net contribution*	0.66	4.0	0.73	0.83
(E) Sugar levies and import duties	0.11	0.7	0.11	0.11
(F) Swiss gross contributions	0.10	0.6	0.10	0.10
(G) Norwegian gross contributions	0.15	0.9	0.15	0.15
Estimates of potential savings through NExit				
EFTA + bilateral (D-(E+F))	0.45	2.7	0.52	0.62
EEA (D-(E+G))	0.40	2.4	0.47	0.57
WTO (D-E)	0.55	3.3	0.62	0.72

Source: Capital Economics calculations based on material herein
Note: Dutch rebate savings only begin after the end of the next financial framework in 2021. The figure for 'EU spending in the Netherlands' is lower after NExit to reflect the twenty per cent savings we have assumed that the Dutch government implements when it has control of what was previously European Union expenditure.

We have taken a cautious approach when considering how quickly the Netherlands can reduce its fiscal payments to Brussels. It is unlikely contributions can stop immediately in 2015, since the 2015 budget will already have been agreed to in 2014. It would create a problem for other member states immediately as they would have to increase contributions to cover the Dutch reduction, while European Union treaties obligations may still apply. We assume that the Netherlands would stop its income based contributions in 2016. In 2016 the Netherlands would be in a position to take responsibility for (i.e. pay for) European Union expenditure in the Netherlands itself. The Netherlands would stop making its value added tax and gross national income based contributions in 2016, which are the components based on the relative size of the Dutch economy and make up the majority of contributions, though the they would still have to make trade-related contributions.

European Union treaties will cease to apply at the beginning of 2017. Thereafter, the Netherlands would have to make no further contributions to the European Union budget other than those agreed to in a negotiated withdrawal, for example for access to the single market.

In 2017 the Netherlands would not make 'traditional own resource' contributions. These comprise of revenue from sugar sector levies and customs duties. Each member state in the union is allowed to retain 25 per cent of the revenue that is collected, so reported contributions are net and only show 75 per cent of the actual total amount collected. After NExit the Netherlands would miss out on revenue raised from levies and duties, equivalent to 0.11 per cent of gross national income as we assume all import tariffs are removed on exit from the European Union.

Modelled impact by 2035 (conservative estimate): Reduced contributions to the Brussels' budget could lead to a cumulative addition to the Netherlands' gross domestic product of €240 billion (2013 prices) over the period between 2015 and 2035 in our Swiss-like 'EFTA + bilateral' scenario.

14.3 Regulation

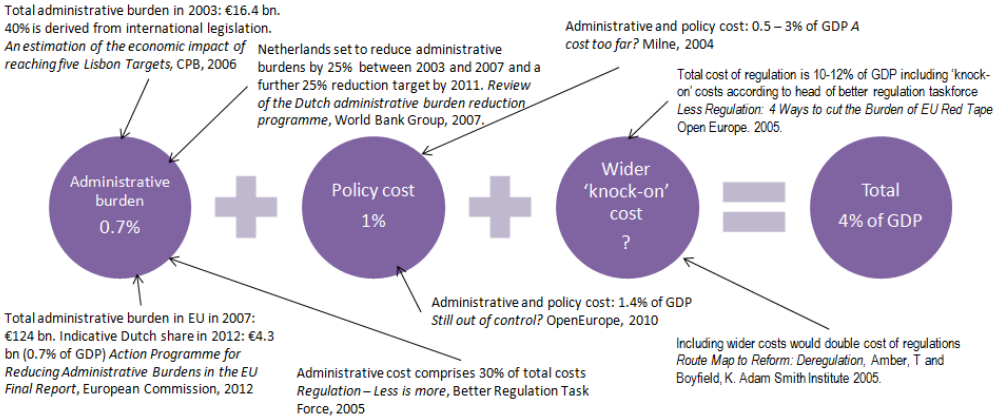
After NExit, the Netherlands would no longer have to implement many of the regulations imposed by the European Union and would be free to shape its own regulatory environment to promote business activity and economic growth. In order to calculate the impact of NExit through regulatory reform we have drawn on existing research which compares the costs and benefits of nationally imposed and European imposed regulation.

First, we look at estimates of the gross cost of regulation from the European Union. This is split into three components: the administrative burden; the policy cost; and the wider 'knock-on' cost to the economy.

For administrative and policy costs we have used conservative estimates of 0.7 and 1.0 per cent of gross domestic product respectively. (See Chapter 4.)

The wider 'knock-on' costs are likely to be large, but the empirical evidence is scarce. As a result we use a conservative estimate for the total cost of European Union regulations in the Netherlands of four per cent of gross domestic product, although there are some much higher estimates out there. (See Figure 83.)

Figure 83: Our conservative estimate of the cost of regulations



Source: Capital Economics

Second, we assume that any European Union regulations transferred are replaced by national ones. If the Netherlands retains ties to the European Union through the single market after NExit, some European Union regulation will have to be maintained. Estimates suggest that Norway adheres to around 75 per cent of regulation, the figure we use in our 'EEA' scenario.[57] However the Netherlands could have a relationship with the European Union more like that of Switzerland, in which the extent of European regulation adopted is lower.[58] Therefore, in the 'EFTA + bilateral' scenario we assume that the amount of regulation transferred back into the purview of the Dutch government is halfway between that in the 'EEA' scenario and the 100 per cent assumed in the 'WTO' scenario.

Third, we determine how much more effective regulation implemented nationally is likely to be compared to that at a pan-European level. Open Europe look in detail at the impact assessments of regulations in the United Kingdom to assess the benefit to cost ratios.[59] They find that, although overall the benefits of regulation outweigh the costs, the benefit to cost ratio is almost two and a half times bigger for domestic regulations compared to European regulations. There is no reason to believe that this ratio would be significantly smaller in the Netherlands, given its relatively good record in creating a strong regulatory environment. Therefore, for every regulation transferred from Brussels to *Den Haag* after NExit, we have reduced its costs in line with the difference in the benefit to cost ratios.

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[57] Report by the EEA Review Committee, *Outside and Inside – Norway's agreements with the European Union*, (Norwegian Ministry of Foreign Affairs, Oslo), 2012. Refer to Chapter 28.2 at http://www.regjeringen.no/nb/dep/ud/dok/nou-er/2012/nou-2012-2/29/2.html?id=669881 (in Norwegian) (accessed 07-01-2014)

[58] See Daniel Hannan blog on *Telegraph* website at http://blogs.telegraph.co.uk/news/danielhannan/100186074/ (accessed 07-01-2014)

[59] Sarah Gaskell and Mats Persson, *Still out of control? Measuring eleven years of EU regulation* (Open Europe, London), 2010. pp1-3

Fourth, to convert the cost savings into an impact on gross domestic product we use the findings of the *Centraal Planbureau's* study into compliance with Lisbon targets.[60] The research provides an estimate of the relationship between regulatory burden and output. This particular study is used as it is detailed and specific to the Netherlands; however, a similar relationship can be found in other research which looks at different countries.

Modelled impact by 2035 (conservative estimate): Based on these calculations, NExit under the 'EFTA + bilateral' scenario would lead to an extra €326 billion (2013 prices) in cumulative gross domestic product over the period between 2015 and 2035, purely from a reduction in the regulatory burden.

14.4 Immigration

After NExit the Dutch government would be free to shape its own immigration policy and reduce the fiscal burden of some groups of immigrants. Our calculations of impacts largely draw on work done previously in this area by Nyfer.[61]

In taking a cautious approach to quantifying the potential impact of reclaiming national control over immigration, we have considered directly only the withdrawal from the European Union's family reunification and qualification directives. After NExit the Dutch government would no longer be required to accept immigrants from outside the union for family re-unification and asylum purposes. Based on 2011 figures, that implies a drop of 55 per cent in non-western immigrants.[62]

There will be scope for further savings outside the European Union that are not included in our modelling. For example, the government could withdraw residency permits from unemployed immigrants, who have previously qualified for long term residency, or they could restrict access to benefits for non-native workers. All of these would add to the savings from immigration policy post-NExit. Meanwhile, we do not specifically assess options relating to

[60] George Gelauff and Arjan Lejour, *An Estimation of the impact of reaching five Lisbon Targets* (*Centraal Planbureau, Den Haag*), 2006.pp 103-107

[61] L. van der Geest and A. J. F. Dietvorst, *Budgettaire effecten van immigratie van niet-westerse allochtonen* (Nyfer, Utrecht), 2010.

[62] The *Centraal Bureau voor de Statistiek* classifies immigrants as 'western' or 'non-western'. 'Non'western' is defined as persons with a Turkish, African, Asian and Latin-American background. For more information see: Maarten Alders, *Classification of the population with a foreign background in the Netherlands* (*Centraal Bureau voor de Statistiek, Den Haag),* 2001. p3

preventing western immigration because of a lack of suitable data, although there may be further benefits to the taxpayer to be had from this after NExit.

For each annual wave of non-western immigrants that are refused entry after withdrawing from the family reunification and qualification directives, Dutch authorities will save an estimated lifetime discounted value of €4.0 billion in avoided net public expenditure. This figure is 55 per cent of the €7.2 billion estimated by Nyfer as the total lifetime discounted cost of non-western immigration to the Netherlands.[63] The original calculations by Nyfer reflect a conservative assumption of 25,000 non-Western immigrants arriving each year, who have on average one child each.

Our modelling is not done on a lifetime discounted basis; we look at only the costs and benefits which occur in each particular year. Using Nyfer's lifetime discounted value figures we back-calculate the savings to the tax payer from each immigrant denied entry in each year of his or her life. The result of this is that in the first year after NExit the saving will be small because only one year's worth of migration will have been prevented. However, as successive annual waves of immigrants are stopped the benefits will accumulate. Moreover, this is compounded by continued growth in migration. So by 2035, the annual saving will amount to €7.5 billion in 2013 prices.

Using the Nyfer estimates, we calculate that preventing all non-western immigration would yield a cumulative increase in gross domestic product of €198 billion by 2035 (in today's prices). For our assessment, we take a more cautious view. We consider only the impacts of withdrawing from the family reunification and asylum qualification directives (which yields an accumulated €109 billion by 2035), plus an uplift of 50 per cent (€54 billion) for the likely benefits from reducing other non-economically beneficial immigration, both in the remaining non-western and western categories, for which we have no specific data.

Modelled impact by 2035 (conservative estimate): Overall, revising immigration policy to focus more tightly on admitting only those who make an economic contribution would lead to an extra €163 billion (2013 prices) in cumulative gross domestic product over the period between NExit and 2035. This is applied to all three scenarios for the Netherlands' relationship with the European Union after NExit.

63 L. van der Geest and A. J. F. Dietvorst, *Budgettaire effecten van immigratie van niet-westerse allochtonen* (Nyfer, Utrecht), 2010

14.5 Trade

The impacts of NExit on trade, and its economic consequences, are complex. There are factors that will tend to increase and to decrease trade, and no model can reflect them perfectly.

The consequences of NExit which we consider in our modelling are best disentangled as the answers to a series of key questions:

- What will be the nature of the future trade relationship (and possible agreement) between the Netherlands and European Union?
- What tariffs and restrictions will be introduced on trade between the Netherlands and the European Union?
- What tariffs and restrictions will be introduced on trade between the Netherlands and the European Union in goods that have third party country components or are third party country re-exports?
- How will tariffs and restrictions on trade between the Netherlands and non-European Union countries change?
- How will new freedoms to agree bilateral trade agreements with third party countries impact on growth in non-European Union trade?

The most likely outcome is that the Netherlands retains access to the single market after NExit. Both Norway and Switzerland enjoy the benefits of free trade with counterparts in the European market without membership of the European Union.

However, the trading relationship between the Netherlands and the European Union will be determined through negotiations during the exit process and there are numerous possible outcomes. (See Figure 84.)

We have considered the impact on trade of two plausible scenarios in which the Netherlands retains access to the single market. In the first, the Netherlands joins the European Free Trade Association and negotiates bilateral trade agreements with the European Union, akin to Switzerland's current position. In the second, the Netherlands signs up to the European Economic Area agreement, through the European Free Trade Association, in the same manner as Norway. We also consider the case in which the Netherlands loses access to the single market and has its trading status determined by the rules of the World Trade Organisation.

Figure 84: Possible trade arrangements with the European Union

Source: Capital Economics

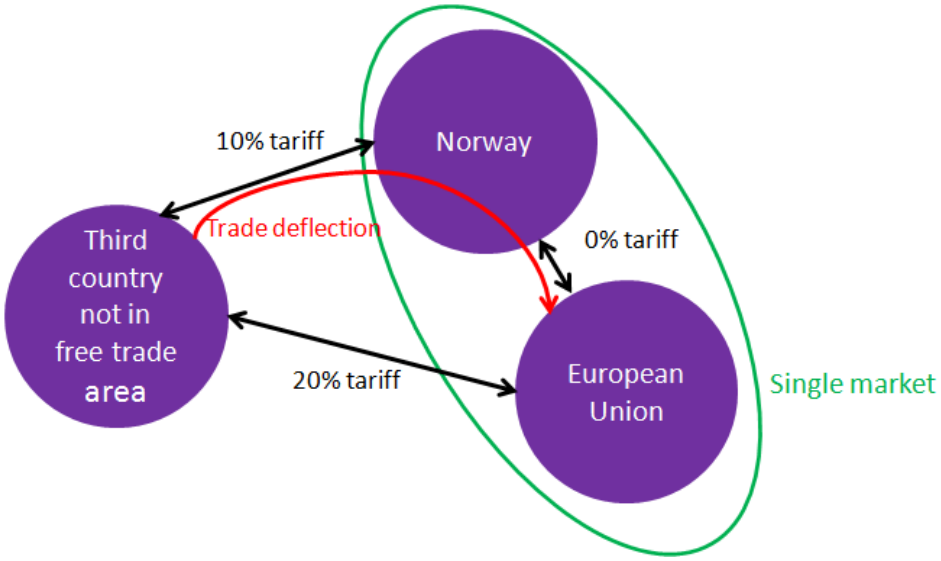
In any scenario, there will be some additional costs to Dutch businesses exporting to the European Union.

Once outside the customs union Dutch exports to the European Union will be subject to rules of origin, which are imposed in order to prevent trade deflection, whereby goods are imported into the free trade area through a country with a lower external tariff. (See Figure 85.)

These rules impose additional burdens on businesses, which are required to undertake administrative procedures to prove the origin of their goods. For some goods, which are wholly produced in one country, this is a fairly straightforward task. However, with ever globalising supply chains, it can become quite complex for goods with components coming from a number of different countries. Measuring the overall cost of this burden isn't easy, but based on the studies which have attempted to do so, we have used a conservative estimate of three per cent of the value of exports.[64]

[64] Paul Brenton, *Rules of Origin in Free Trade Agreements* (The World Bank Group, Washington), 2013. p4

Figure 85: Illustrative example of trade deflection in the absence of rules of origin



Source: Capital Economics

Some Dutch exports, that have significant foreign components, will fail to meet origin criteria and be subject to further costs.

The specific rules applied to determine the origin of a good vary by country and by product type. The most commonly applied take the form of an *ad valorem* criteria or a change of classification tariff criteria. The former requires that a certain percentage of the value of a product comes from the origin country while the latter requires that the good is processed sufficiently in the origin country to change its tariff classification code.

In order to comply with these rules, some exporters will need to adjust their production processes. This may include, for example, switching to suppliers within the free trade area, which can lead to a reduction in competition and efficiency. Estimates of the total cost of complying with rules of origin are scarce. However, if they exceed the cost of tariffs that would be imposed without compliance, exporters will choose to pay these instead — and so we can use this as an upper bound.[65] Given that the weighted average tariff based on the current product mix is 5.5 per cent, and we have estimated administrative costs of three per cent, we have assumed that the upper bound for compliance costs is 2.5 per cent.

Meanwhile, if the Netherlands does leave the single market, tariffs will be imposed on its trade with the European Union. We have assumed that, as members of the World Trade Organisation, the maximum tariffs under the 'most favoured nation' regime are applied to exports and imports between the Netherlands and European Union members. (See Figure 86.)

[65] Olivier Cadot, Jaime de Melo, Antoni Estevadeordal, Akiko Suwa-Eisenmann and Bolormaa Tumurchudur, *Assessing the Effect of NAFTA's Rules of Origin*, 2002. pp 3-4

Figure 86: Tariffs and restrictions on European Union trade after NExit

Source: Capital Economics

Figure 87: Trade policy freedoms after exit from the European Union

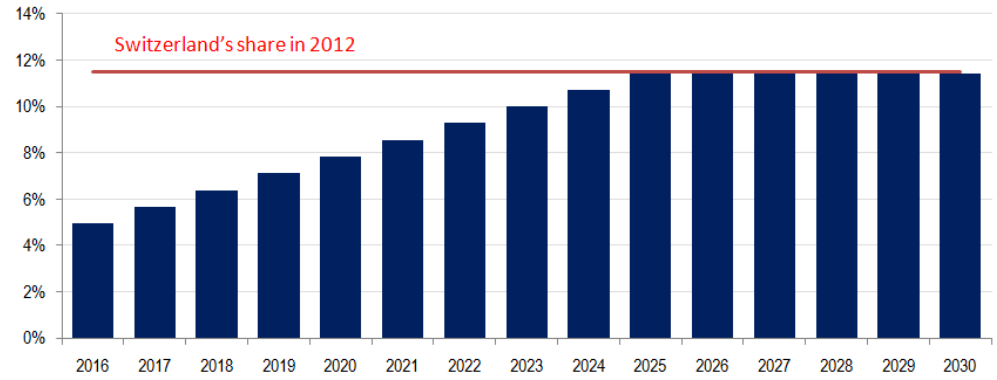
Source: Capital Economics

Not all exports will be affected in the same way. Around 40 per cent of Dutch exports are 're-exports'. That is, goods which are imported into the Netherlands and undergo little or no transformation before they are exported. The *Centraal Planbureau* estimates that the average value added to re-exports in the Netherlands is 7.5 per cent. After NExit, tariffs will be imposed on re-exports destined for the European Union. However, as 92.5 per cent of the value of these goods is already subject to tariffs, the impact will be negligible.

NExit also provides opportunities for faster growth in trade. Once outside the European Union, the Netherlands will be free to negotiate its own trade agreements with third party countries. Taking control of its own trade policy will provide an opportunity for the Netherlands to focus its efforts on increasing trade with faster growing markets outside of the European Union. Without a common external tariff the Dutch will not only be able to remove tariff barriers, but also work to reduce non-tariff barriers, such as regulatory requirements on products.

We have conservatively assumed that, outside the European Union, the Netherlands gradually increases its share of exports to the BRIC economies to be in line with Switzerland by 2025. (See Figure 88.)

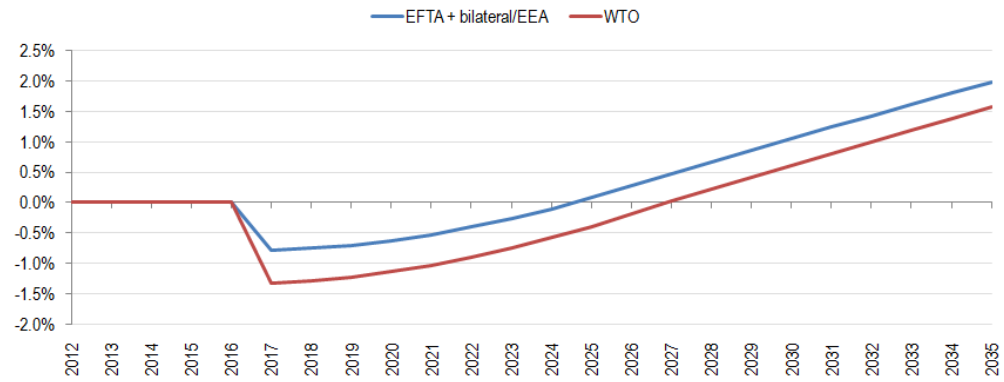
Figure 88: Assumptions for the share of Dutch exports destined for the 'BRIC' economies



Source: Capital Economics

The benefits of increased trade outside the European Union will eventually outweigh the increased costs of trade within the bloc. Our calculations suggest that the initial extra costs introduced after NExit, and the subsequent loss of European Union trade, will be offset in the long term by a shift towards trade with faster growing markets. (See Figure 89.)

Figure 89: Percentage difference in gross domestic product relative to Netherlands (no further periphery support)



Source: Capital Economics' analysis of international trade centre data

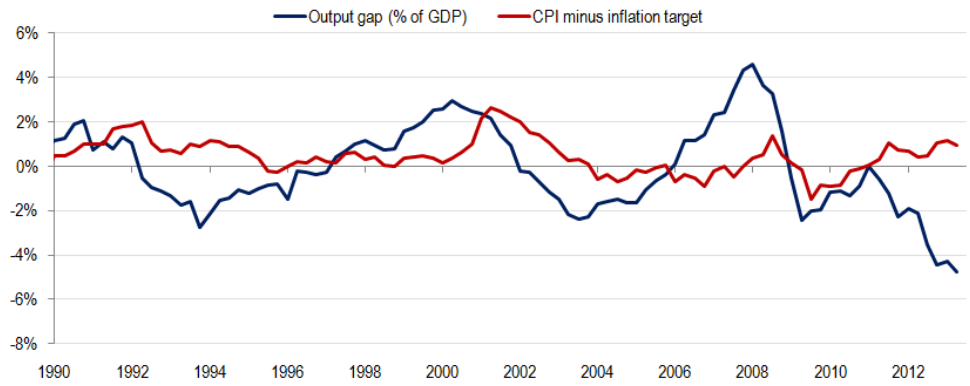
Modelled impact by 2035 (conservative estimate): Overall, between 2015 and 2035 NExit is likely to bring an additional €66 billion in cumulative gross domestic product to the Netherlands through improved trade relationships in our Swiss-like 'EFTA + bilateral' scenario.

14.6 Monetary policy

Outside the euro, Dutch authorities will be able to set their own, and the most appropriate, monetary policy for their economy. Our assessment of the potential for improved monetary policy is based on our own modelling of how much a better policy stance could achieve.

To understand what monetary policy might look like if set for the Dutch economy rather than the euro-zone as a whole, we have fitted a 'Taylor rule' to the Netherland's economy based on the European Central Bank's previous actions. The Taylor rule supposes that the central bank policy rate is driven by deviations of inflation from its target and of output from its potential.[66] (See Figure 90.)

Figure 90: Output gap as share of gross domestic product and inflation minus target rate (% y/y)



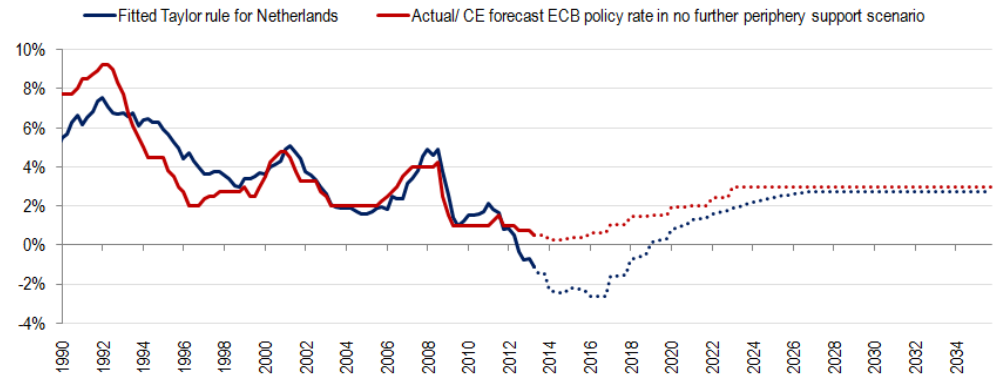
Source: Capital Economics' analysis of Eurostat data

The relative weight given by the central bank to deviations in inflation and output in their decision about the policy rate can be estimated using statistical analyses of historic data. From this we can analyse how a central bank is likely to react given inflation and the gap in output.

This analysis also tells us that the Dutch economy needs monetary loosening well beyond what the European Central Bank will provide through rate cuts alone. Further unconventional monetary policy may well be appropriate, such as the significant quantitative easing programs deployed in the United Kingdom and United States. (See Figure 91.)

[66] For more information see: John Taylor, 'Discretion versus policy rules in practice', *Carnegie-Rochester Conference Series on Public Policy*, vol. 39, issue 1, 1993. pp 195-214

Figure 91: Forecast Taylor rule for the Netherlands based on European Central Bank monetary policy since 1999

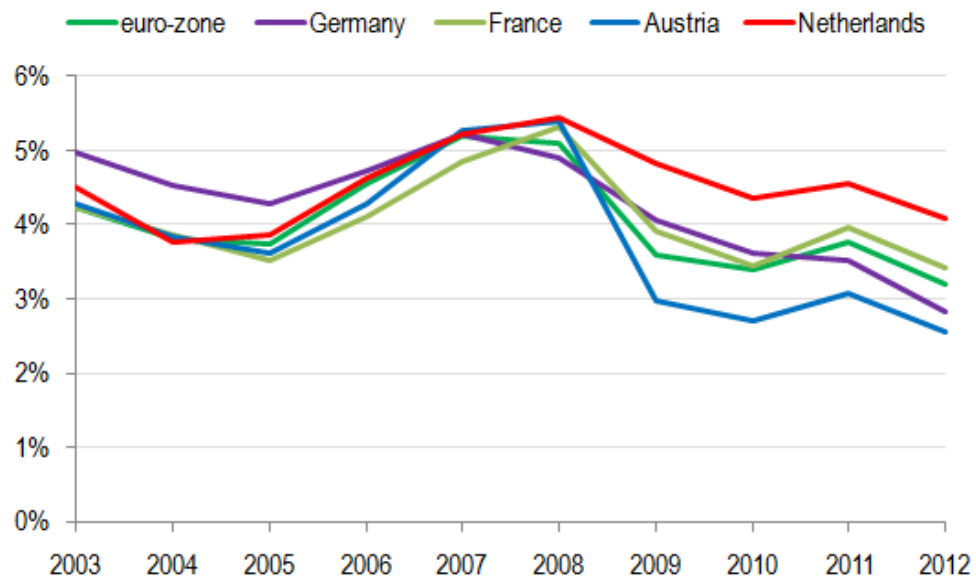


Source: Capital Economics

Not only does the current base rate appear inappropriately high for the Netherlands, but transmission of European Central Bank rate cuts have been ineffective; reflected in large and increasing spreads between the lending rates charged on retail banking customers and base rates.

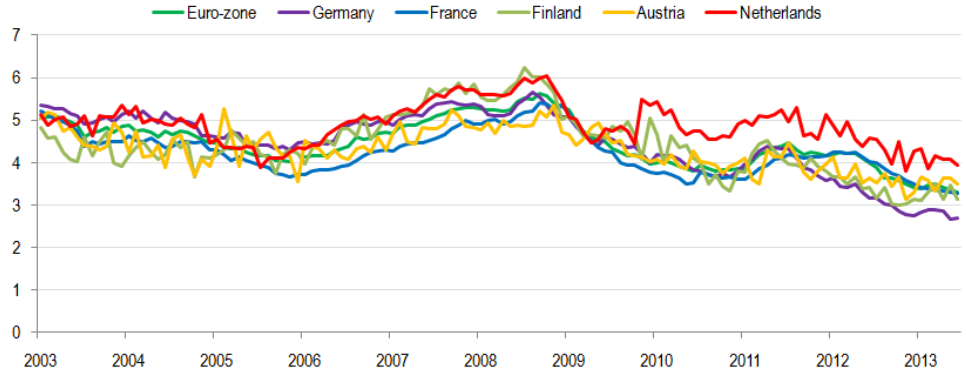
Mortgage rates in the Netherlands are 100 basis points higher than the euro-zone average and the spread between base and retail rates for small and medium sized enterprises is well above other 'core' countries. (See Figure 92 and Figure 93.)

Figure 92: Agreed annualised percentage interest rate of new housing loans to households



Source: Eurostat

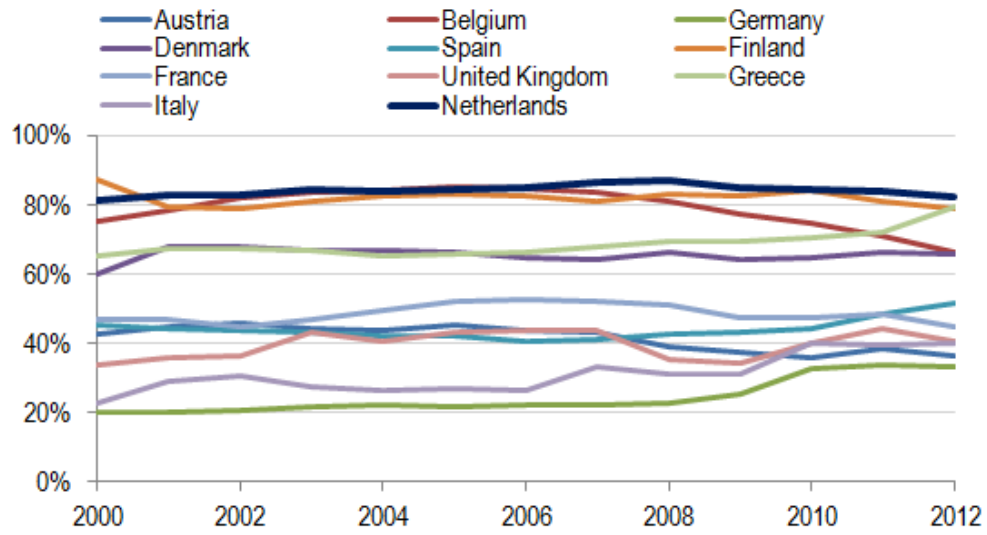
Figure 93: Lending to non-financial corporates, annual percentage rate for new business over 5 years & under €1m



Source: European Central Bank

There are several structural issues which have contributed to relatively higher interest rates on banks' retail lending. First, prior to the crisis Dutch banks were heavily reliant on wholesale market funding and are now under severe pressure to restructure their balance sheets to increase liquidity ratios and reduce exposure to risky assets. This includes retail loans. Second, the Dutch housing market has experienced a dramatic slump, making mortgages more risky for banks, who are in turn pricing in the extra risk. Third, in return for state aid in 2009, restrictions were imposed on three of the four largest banks in the Netherlands which prevented them from being 'price leaders' on interest rates (ING and Aegon have now had these restrictions repealed). Given the concentration of the Dutch retail banking sector, that restriction has significant implications for competition in the retail banking market and, ultimately, prices. (See Figure 94.)

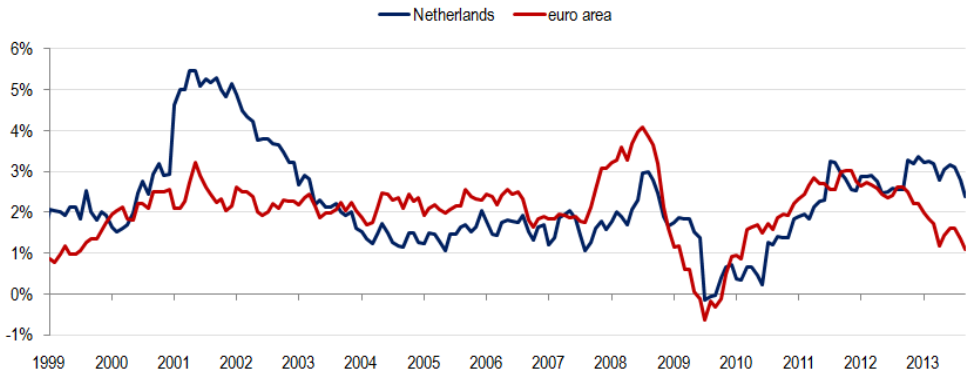
Figure 94: Market share of the five largest banks in selected euro-zone countries



Source: *Centraal Planbureau, The Dutch housing market – mortgage interest rates, house prices and consumption (Centraal Planbureau, Den Haag),* 2013

Outside the European Union the Netherlands will have more tools available to lower interest rates. Not only will the Netherlands no longer be bound by state aid rules, but *De Nederlandsche Bank* will be able to assist banks in the restructuring of their balance sheets, using their own liquidity and asset purchase programmes. As a result of proactive policy after exit we could plausibly see a reduction in retail interest rates of more than the current European Central Bank rate of ¼ per cent.

Figure 95: Annual percentage change in harmonised indices of consumer prices



Source: Eurostat

Some may have concerns any that monetary loosening after exit will stoke inflation in the Netherlands, which is already above euro averages. However, there is little to suggest that current inflation will persist. Price changes are

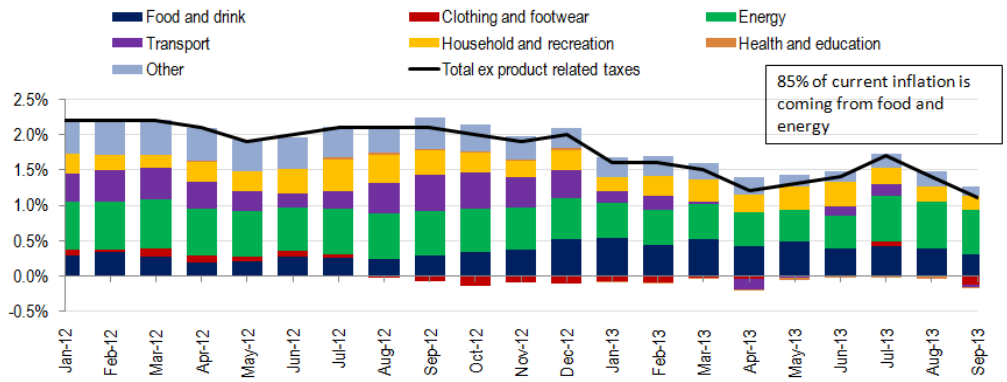
largely being fuelled by recent increases in sales taxes, which are themselves the result of euro inspired austerity. (See Figure 95 and Figure 96.)

If taxes are stripped out of the price data, 85 per cent of recent inflation has arisen from food and energy prices, which in contrast to prices in other sectors are driven primarily by world commodity markets as opposed to excess domestic demand. Both of these observations suggest that looser monetary policy is not a significant price risk. (See Figure 97.)

Figure 96: Annual percentage change in consumer price indices

Source: *Centraal Bureau voor de Statistiek*

Figure 97: Contributions to the annual percentage change in consumer prices excluding product related taxes

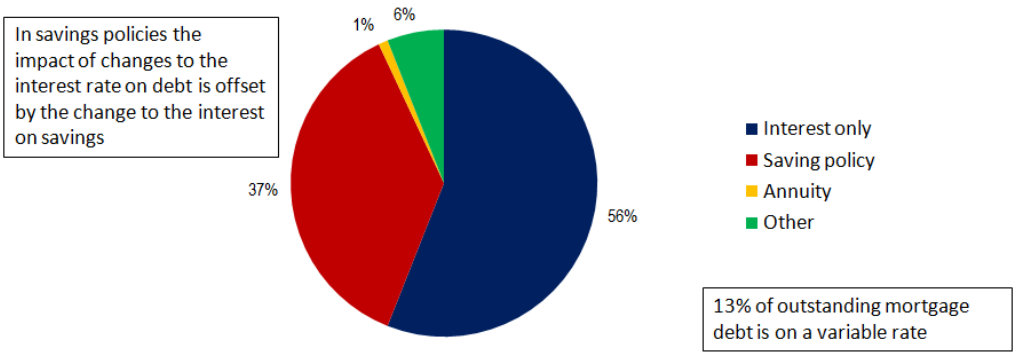


Source: *Centraal Bureau voor de Statistiek*

Between lower base rates, quantitative easing and initiatives to reduce the retail to base rates spread, we believe there is scope in the near term for at least the equivalent of a 50 basis points of monetary loosening against European Central Bank policy, without it being inflationary.

Looser monetary policy will add to gross domestic product in the short term. If consumers and businesses are making lower interest payments, then they have more money to spend and invest. However, the translation of lower interest rates to consumer savings is not straightforward.

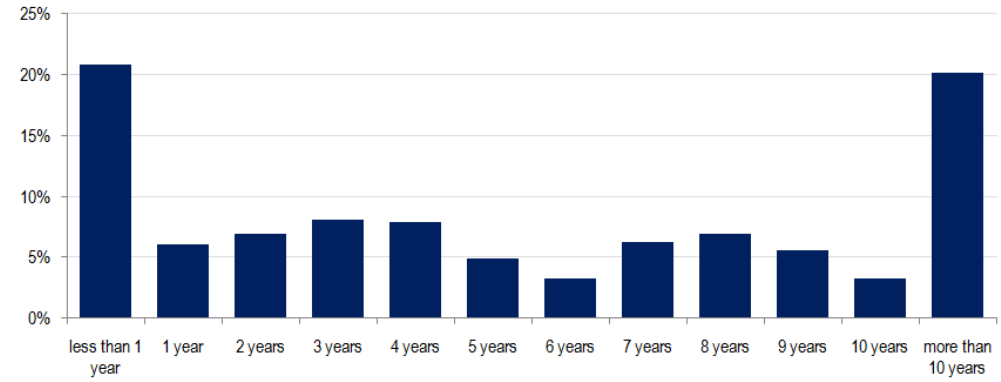
Figure 98: Mortgage debt by type of mortgage, 2010



Source: Vereniging Eigen Huis, *Financiering van de Nederlandse koopwoningmarkt* (Vereniging Eigen Huis, Amersfoort), 2012

The impact of interest rate cuts on the household sector will be dampened by the nature of mortgage contracts in the Netherlands. Eighty seven per cent of mortgages are fixed rate and 37 per cent have linked savings policies, whereby any changes in interest payments are offset by lower returns on savings. What's more, a large share of borrowers have over five years left on their current terms, which further mutes the immediate impact of monetary loosening on households' cash flow. (See Figure 98 and Figure 99.)

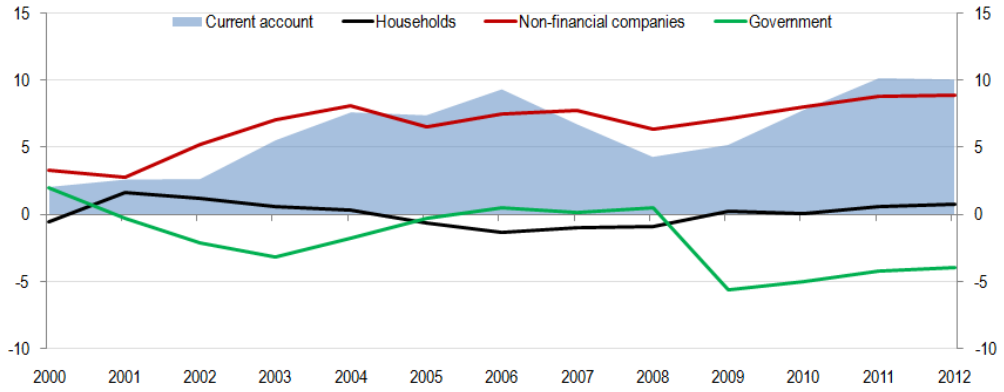
Figure 99: Residual maturity of outstanding mortgage debt



Source: *Vereniging Eigen Huis, Financiering van de Nederlandse koopwoningmarkt (Vereniging Eigen Huis,* Amersfoort), 2012

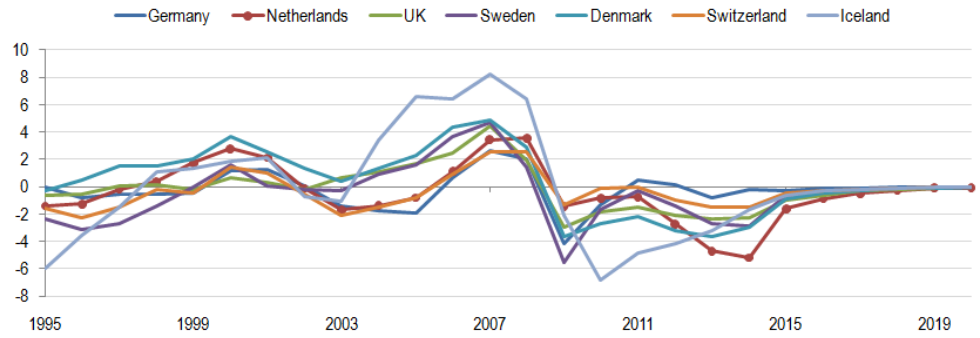
Looser monetary policy may also encourage Dutch firms and households to borrow more, which will have a positive impact on economic growth in a period when any growth is hard to come by. This is more likely to be the case for firms, given that some households are too indebted to increase their borrowing levels significantly. (See Figure 100.)

Figure 100: Net lending by sector as a share of gross domestic product (%)



Source: Thomson Datastream

Figure 101: Output gap as a percentage of potential gross domestic product



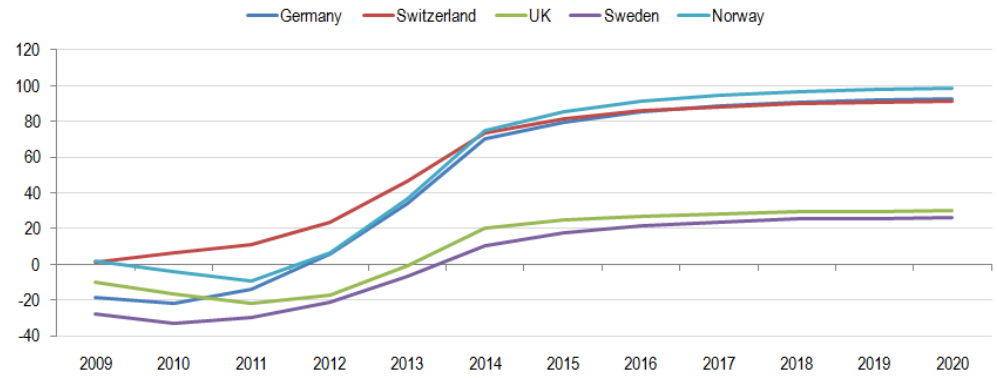
Note: Forecasts to 2014 are taken from OECD Economic Outlook, Volume 2013 Issue 1. From 2015 onwards they are taken from Economic Outlook No 91 - June 2012 - Long-term baseline projections

Source: Organisation for Economic Co-operation and Development

In order to quantify the potential benefits of monetary policy freedom, we have taken the Organisation for Economic Co-operation and Development's forecasts and calculated how much better off the Netherlands would be if its monetary policy were as effective in reducing the projected output gap as comparator central banks elsewhere.

If the Dutch economy were managed as well as the European Central Bank manages the German economy, Dutch national income would be boosted by €92 billion over the course of the downturn (2009-2020). Likewise, if Dutch monetary policy were to deliver what is expected from *Schweizerische Nationalbank* in Zurich, an extra €91 billion of gross domestic product would be added over the period. We have used these values (although cautiously reducing them to reflect the shorter time horizon) to assess the potential benefit of Dutch-focussed monetary policy for the 2015-2020 period. We prudently assume that it takes around eighteen months to have an initial effect.

Figure 102: Cumulative gain (loss) if the Netherlands had had the output gap of Germany or Switzerland, 2013 € billions



Source: Capital Economics' calculations using Organisation for Economic Co-operation and Development data

Over future business cycles an independent monetary policy could deliver further significant benefits.[67]

The ability to offset contractions in domestic demand could bring considerable and regular benefits. The magnitude of the current crisis is exceptional in the post war period and we would not necessarily expect downturns in the near future to be so large. We have therefore assumed that independent monetary policy will eventually deliver annual benefits equivalent to half those in the 2009-2020 period.

Modelled impact by 2035 (conservative estimate): Over the period between 2015 and 2035 monetary policy flexibility will bring an additional €226 billion in cumulative gross domestic product.

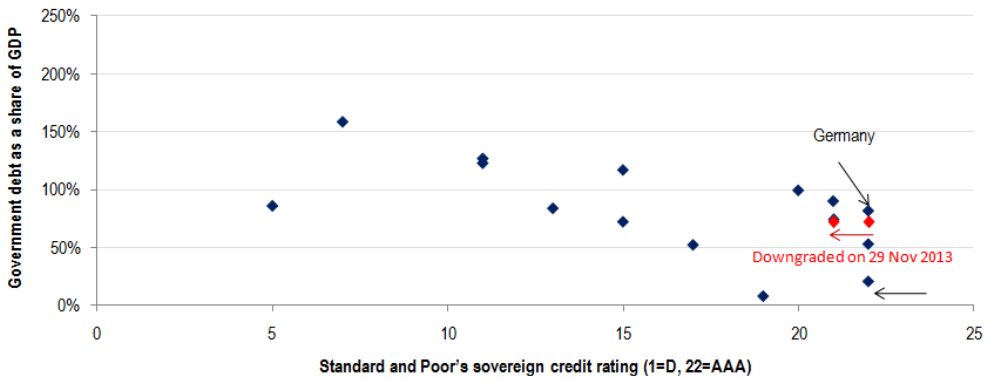
14.7 Fiscal stimulus

After NExit, freed from the restraints of European deficit reduction targets the Dutch government will be able to implement a fiscal stimulus. The impact on gross domestic product will depend on the size of the fiscal multiplier and how markets react to increased spending.

Despite the recent downgrade by Standard and Poor's the Netherlands has a debt position which places it well in the pack of Europe and other industrialised economies. Indeed, comparing across countries suggests that the Netherlands has room for a material fiscal expansion. (See Figure 103.)

[67] The view that the Netherlands would be better off with a new guilder is supported in: Centre for Economics and Business Research, *Cebr's World Economic League Table* (Centre for Economic and Business Research, London), 2013. p9

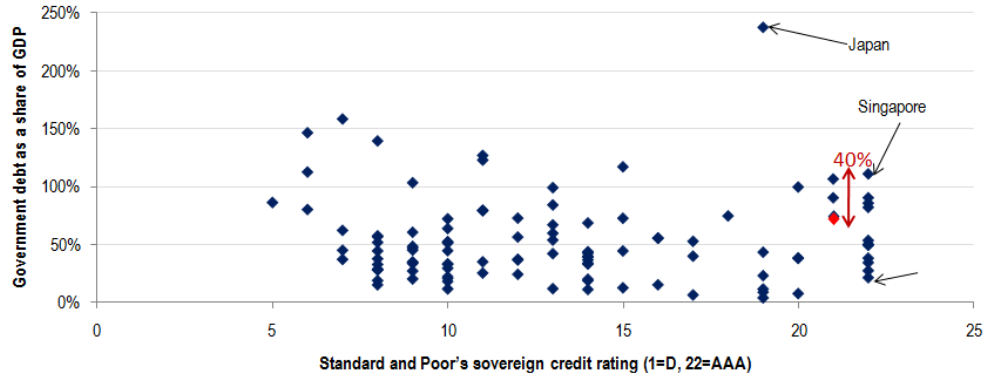
Figure 103: Gross public debt and sovereign credit ratings in the euro-zone



Source: International Monetary Fund and Trading Economics

Singapore currently has an AAA credit rating even though levels of government debt are 40 percentage points of gross domestic product higher than the Netherlands. (See Figure 104.)

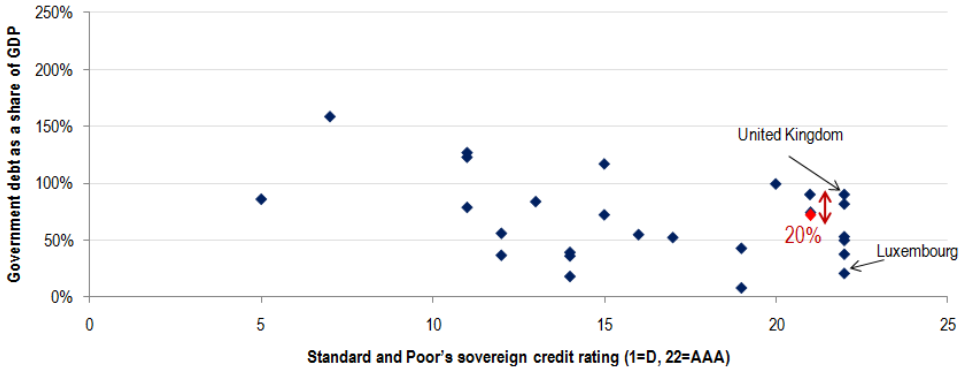
Figure 104: Gross public debt and sovereign credit ratings



Source: International Monetary Fund and Trading Economics

Indeed, at 70 per cent, the Netherlands' debt ratio is lower than AAA rated economies in the European Union: the United Kingdom's ratio is 90 per cent and Germany's 80 per cent. (See Figure 105.)

Figure 105: Gross public debt and sovereign credit ratings in the European Union



Source: International Monetary Fund and Trading Economics

The scale and implementation of any fiscal stimulus is a matter of (political) judgement. But we believe that, in the current unique economic climate, a reasonably large fiscal stimulus package is both justified and needed. Accordingly, we have assumed a boost of two per cent of gross domestic product for the first three years starting in 2015, which is withdrawn at an annual rate of 25 per cent thereafter.

The current economic conditions also demand a review of any 'multipliers' used to convert addition government spending into national income. In 'normal' (pre-1998) circumstances, we would be cautious about assuming that more government spending means higher domestic product. In a properly functioning economy operating near full employment, additional government expenditure all too often displaces other higher value private sector activity that would have happened otherwise. In our assessment of NExit, we have cautiously assumed just that, with a multiplier of 0.65 applied to fiscal stimulus after 2017, which is well within the range quoted by academics and in the middle of *Centraal Planbureau's* range for longer term forecasting.[68]

But these are far from normal conditions – and, in an economy with substantial spare capacity and depressed consumer demand, a well considered package of fiscal measures could have a substantial stimulus impact well in excess of its initial budget value.

Of course, there is much debate over the scale of so-called 'crisis multipliers'. There are numerous arguments for why the multiplier could be large or small, or in between.[69] But in the current Dutch circumstances, the logic points to

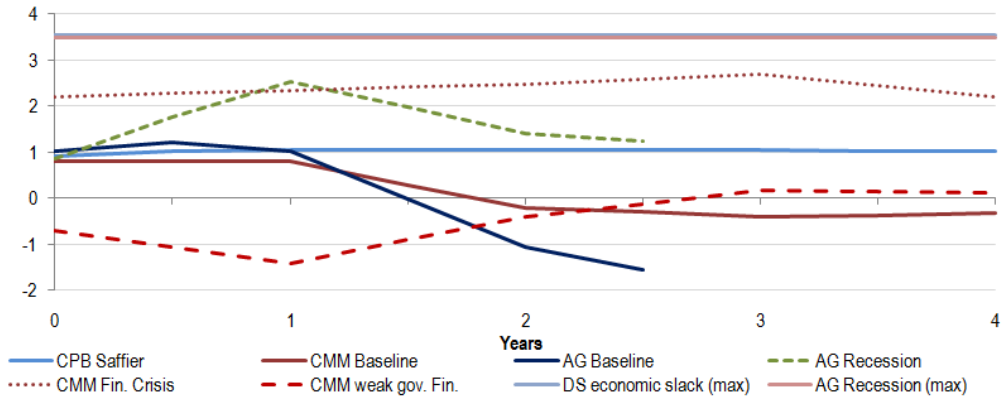
[68] Henk Kranendonk and Johan Verbuggen, SAFFIER: A multi-purpose model of the Dutch economy for short-term and medium-term analyses (*Centraal Planbureau*, *Den Haag*), 2007. pp68-69

[69] Organisation for Economic Co-operation and Development, *The effectiveness and scope of fiscal stimulus, OECD Economic Outlook Interim report March 2009* (OECD Publishing, Paris), 2009.

something at the upper end of spectrum. As such, for any stimulus delivered in the 2015-2017 period, we have applied a crisis multiplier of 1.5 in the first year of impact only. This looks large against the pre-2008 literature, but is within the range of evidence being provided by academics and authorities in recent years, and we believe is realistic (indeed, conservative) in the current extreme circumstances. (See Figure 106.)

(Nevertheless, we have stress tested our overall results against our assumptions on scale of the fiscal stimulus package and the level of crisis multiplier. See Chapter 15 for details.)

Figure 106: Estimates of fiscal multiplier

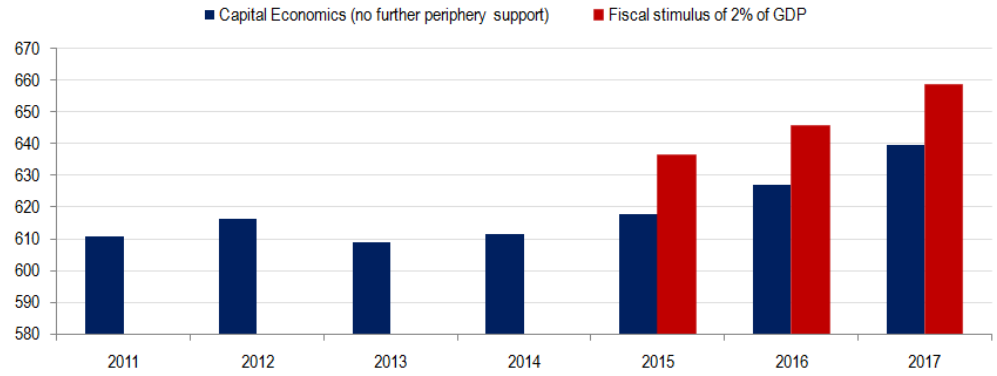


Sources: Centraal Planbureau, *Central Economic Plan*2013 (*Centraal Planbureau, Den Haag*), 2013; Alan Auerbach and Yuriy Gorodnichenko, *Fiscal Multipliers in Recession and Expansion* (University of California, Berkeley), 2011; and Daniel Shoag, *The Impact of Government Spending Shocks: Evidence on the Multiplier from State Pension Plan Returns*, manuscript, 2010.

The fiscal stimulus package improves the short term growth outlook and hence the level of real gross domestic product. (See Figure 107.)

International Monetary Fund, *World Economic Outlook October 2012: Coping with high debt and sluggish growth* (International Monetary Fund, Washington), 2012.
Gabriela Castro, Ricardo M. Félix, Paulo Júlio and José R. Maria, 'Fiscal multipliers in a small euro-zone economy: how big can they get in crisis times?', *Banco de Portugal Economics and Research Department Working Paper*, w201311, 2013.
Tobias Cwik and Volker Wieland, 'Keynesian government spending multipliers and spill-overs in the Euro Area', *European Central Bank Working Paper Series*, No 1267, 2010.
Centraal Planbureau, *Central Economic Plan 2013* (*Centraal Planbureau, Den Haag*), 2013.
Ray Barrell, Dawn Holland and Ian Hurst, 'Fiscal multipliers and prospects for consolidation', *OECD Journal: Economic Studies*, Vol. 2012/1, 2012.

Figure 107: Capital Economics' forecast for real gross domestic product, € billions, 2013 prices



Source: Eurostat and Capital Economics

Modelled impact by 2035 (conservative estimate): The recovery in the Netherlands is stalling and the ability to inject a fiscal stimulus into the economy will help to stimulate growth. By 2035, our post-NExit fiscal stimulus package would add a total of €83 billion in cumulative gross domestic product.

14.8 Currency transition and revaluation

There are costs involved with moving from the euro for a new national currency. First, there are the logistical costs of transition, which include the printing of new currency, redenomination of contracts and the updating of payment systems. We have estimated that this will amount to 0.5 per cent of gross domestic product. (See Chapter 8.) Second, new currency transaction costs will be incurred for intra-European transactions, for which we have assigned a cost equivalent to 0.3 per cent of gross domestic product each year. (See Chapter 9.)

The rest of this section discusses the impact of potential changes to the exchange rate after NExit. Permanent changes or temporary volatility in the exchange rate will have a material impact on trade and the position of individuals and institutions with external exposures. We believe there is unlikely to be any permanent material realignment of the Dutch guilder relative to the euro. (See Chapter 9.) However, there will almost certainly be some short term volatility in the immediate aftermath of NExit.

There are few comparator events to NExit to gauge estimates of currency movements against. Usually currency union exits and devaluations are precipitated by debt or banking crises or a severe overvaluation of the currency and none of these apply to the 'NExit' scenario. Instead we have used the closest examples available and our judgement of the situation. We

therefore assume six months of uncertainty and exchange rate volatility with a depreciation of ten per cent. (See Table 14.)

Looking at three recent northern European examples of crises which resulted in devaluation of twenty per cent we can see there is considerable variation in the overall impact on gross domestic product of a devaluation episode. The reasons for differences are down to severity of the underlying cause (credit and housing bubbles in Finland and Sweden respectively and overvaluation in the United Kingdom) and the handling of the fallout.

Table 14: Main features of recent crises in Northern Europe with significant currency swings

		Months until trough	Size of devaluation	Loss of GDP
Finland	Sep-92	11	-23.9%	-2.40%
Sweden	Nov-92	9	-22.8%	-0.40%
UK	Aug-92	12	-23.1%	0.00%
Average		**11**	**-23.3%**	**-0.9%**

Source: Mark Weisbrot and Rebecca Ray, *Latvia's Internal Devaluation: A Success Story?* (Center for Economic Policy Research, Washington), 2011

Given that the currency swing after NExit would be caused by capital flight purely as a result of uncertainty about the legal status of assets and prospects for the economy outside of the European Union rather than due to structural problems, we would expect impacts to be less severe than shown in Table 14. Therefore we have modelled a devaluation of ten per cent in our 'EFTA + bilateral' scenario and a loss of gross domestic product that is half the average of the Northern European examples shown above (0.5 per cent).

Chapter 11 gives an alternative justification for arriving at a 0.5 per cent short term loss in output, by considering the impacts on the banking sector and how a devaluation would affect their balance sheets.

The initial volatility after NExit will be short lived. Once the uncertainty has cleared, we expect the guilder to stabilise around parity with the euro. This is because there is no structural reason to expect a substantial revaluation. (See Chapter 9 for more discussion.)

However, if there was it would have a significant impact on trade; an appreciated guilder will reduce exports and increase imports, affecting the overall trade balance. We have conducted sensitivity tests, by revaluing the new guilder by ten per cent either way against the euro. Based on existing

literature we use an average estimate of -0.5 for the price elasticity of exports and -0.1 for the price elasticity of imports. (See Table 15.)

Table 15: Estimates of export and import elasticities

Source	Coverage	Price elasticity of export volumes estimate
Jean Imbs and Isabelle Méjean, *Trade Elasticities: A Final Report for the European Commission* (European Commission Economic Papers 432, December 2010), 2010	Germany, UK, France	-1.4 to -1.6
Robert Anderton (ed), *Competitiveness and the export performance of the Euro area* (ECB Occasional Paper Series NO. 30 / June 2005), 2005	Netherlands	-0.35
Patrick Artus, *Flash Economics-No 215* (Natixis, Paris), 2013	Netherlands	-0.5
Peter Hooper, Karen Johnson and Jaime Marquez, *Trade elasticities for the G7 countries* (Princeton University, Princeton), 2000	G7	-0.2 to -1.6
European Commission and the Kiel Institute of the World Economy	euro-zone	-0.25 to -0.35
Reasonable and cautious estimate based on literature		**-0.5 for exports**
Source	**Coverage**	**Price elasticity of import volumes estimate**
European Commission and the Kiel Institute of the World Economy	euro-zone	-0.07 to -0.15
Reasonable and cautious estimate based on literature		**-0.1**

Sources: As indicated.

A change in the exchange rate will have a reduced effect on re-exports, given that only 7.5 per cent of their value added is created in the Netherlands and import and re-export prices can be adjusted to minimise any cost disadvantage from an exchange rate movement.

Overall we estimate that a ten per cent change in the value of the new guilder would generate a total net impact on trade of ± 2.7 per cent, with net trade falling 2.7 per cent after an appreciation. The biggest impact would be on the manufacturing sector. (See Table 16.)

Table 16: Estimates of the change in trade after an appreciation or depreciation of 10 percent, as a proportion of gross value added

Change as % of GVA	Dutch exports ±10%	Re-exports ±10%	Imports ±10%	Net impact ±10%
Agriculture and mining	±3.9%	±0.2%	±2.2%	±1.9%
Manufacturing	±14.0%	±0.8%	±4.6%	±10.2%
Energy	±1.1%	0.0%	±0.1%	±0.1%
Construction	±0.5%	0.0%	±0.1%	±0.4%
Wholesale and retail	±3.1%	0.0%	±0.2%	±2.9%
Transportation	±6.3%	0.0%	±0.3%	±6.0%
Information and communication	±2.1%	0.0%	±0.3%	±1.7%
Low value service	±0.4%	0.0%	±0.2%	±0.2%
Finance and insurance	±4.6%	0.0%	±1.1%	±3.6%
Business and other high value services	±1.2%	0.0%	±0.3%	±0.9%
Public sector	±0.2%	0.0%	0.0%	±0.2%
Total	**±3.5%**	**±0.1%**	**±0.9%**	**±2.7%**

Source: Capital Economics
Note: export elasticity used: -0.5, import elasticity used: -0.1

A permanent change in the exchange rate would also affect holders of foreign assets. If the new guilder appreciated, it would impact upon the value of the income stream from the foreign held assets of Dutch pension schemes. A ten per cent appreciation would leave pension funds with less income from their foreign assets and a shortfall in funding equivalent to 0.9 per cent of gross domestic product. (See Table 17.)

Table 17: Estimates of changes in income from all pension assets after a ten per cent appreciation

	Asset value	Cost of currency movement as % of GDP		
Currency appreciation/depreciation	€ billions	-10%	0%	+10%
Domestic investments	112	0	**0%**	0
Foreign investments	792	0.9%	**0%**	-0.9%
Total investments	903	0.9%	**0%**	-0.9%

Source: Capital Economics' analysis of *De Nederlandsche Bank* statistics
Notes: 1) We have assumed an annuity rate of 7% per annum. 2) We have assumed that 75% of non-euro assets are held outside of the Netherlands.

We do not include a long term revaluation of the guilder relative to the euro and the consequent impact on trade and pension assets in our scenarios, because we believe the effects will be gradual and marginal, and any risks to the economy should be offset by the better overall rates of growth and general business conditions that are themselves stimulating any longer-term appreciation.

Modelled impact by 2035 (conservative estimate): Overall, our analysis suggests that (in the 'EFTA+ bilateral' scenario) NExit will lead to a total

cumulative loss in gross domestic product of €49 billion between 2015 and 2035 through transaction costs and transition to a new currency. Meanwhile, our modelling suggests that short term currency volatility will result in a cumulative loss of €3 billion over the same period.

14.9 Inward investment

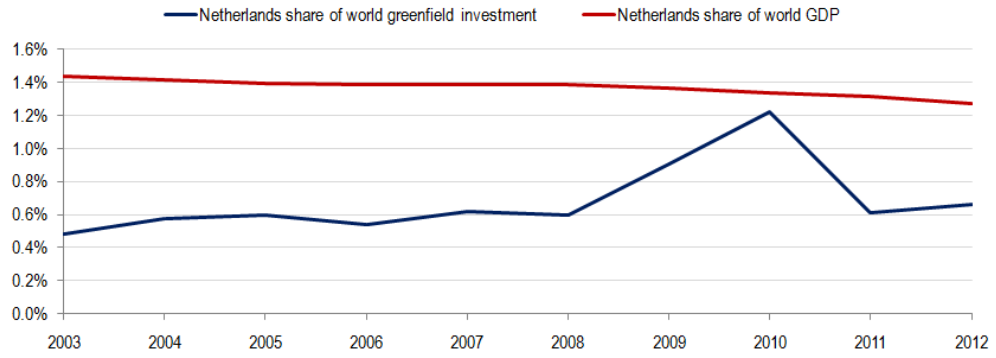
NExit has the potential to affect the decision of foreign firms to invest in the Netherlands, through changing the perception of the country as a place to do business. The impact on inward investment is calculated by identifying the plausible extent to which investment could be increased, given the powers over regulation and trade and investment agreements that the Netherlands would regain on leaving the European Union.

In isolating the impact on gross domestic product from changes in foreign direct investment, we have to be mindful that the majority comes as mergers and acquisitions. This type of inward investment does not show up directly when accounting for gross domestic product, because it is just a transfer of shares and other existing assets to a new owner without new investment goods being purchased. There are some indirect impacts from mergers and acquisitions on productivity and long term propensity to invest, which do count towards gross domestic product, but academic research has not consistently been able to isolate the magnitude of this impact. To err on the side of caution we have not include these impacts in our calculations.

Instead we concentrate on greenfield foreign investment, where a new plant or site is opened. Figure 108 demonstrates that at present the Netherlands does not capture a proportion of greenfield investment appropriate to its size.

Whilst we cannot be sure how investors will view the Netherlands after NExit, it is reasonable to suppose that, with greater regulatory flexibility and the power to unilaterally make trade and investment agreements, the Netherlands could begin closing the gap between its share of world gross domestic product and of greenfield investment.

Figure 108: Netherlands' share of world greenfield investment and world gross domestic product



Source: United Nations conference on trade and development

If the Netherlands achieved a share of greenfield foreign direct investment equivalent to its share in gross domestic product it would mean approximately €12 billion extra investment a year by 2035 (in today's prices), assuming that the total of new greenfield investment globally grows in line with global economic activity. (See Figure 108.)

Modelled impact by 2035 (conservative estimate): To close the whole gap would be tough, given that by their nature developed economies do not present relatively as many greenfield investment opportunities as rapidly developing ones. Instead in our 'EFTA+bilateral' scenario the Netherlands closes half of that gap. This means that over the period between 2015 and 2035 the cumulative addition to gross domestic product from increased foreign investment will be €69 billion.[70]

The boost to inward investment could be particularly beneficial to certain sectors. If new investment follows the same pattern as the current stock of inward investment, the chemicals sector would be the biggest beneficiary with €12.9 billion of extra investment by 2035. There would also be similar sized benefits for the financial services, other manufacturing and food sectors. (See Table 18.)

[70] In order to test the robustness of our results fully, in the 'WTO' scenario we take an ultra cautious approach and assume that there is no further investment in the Netherlands by foreign multinationals after NExit.

Table 18: Cumulative increase in inward investment by 2035 in top 5 sectors, € billions

	'EFTA + bilaterals' with 'No further periphery support'	Exemplar companies in each sector
Chemicals	12.9	Dow, Teijin
Financials	12.5	Industrial and Commercial Bank of China
Other manufactures	11.9	Bioventus, Midwest Rubber, Invista
Food products	11.2	Heinz, Yakult, Dawn Food Products
Transport	5.7	Tesla motors, Apollo Tyres, Damco

Source: Capital Economics' analysis of Organisation for Economic Cooperation and Development's data

15 THE OVERALL IMPACT OF NEXIT

In this chapter, we conclude our quantitative evaluation of NExit, and assess the combined effect on Dutch economic performance of the various impacts we have identified.

We have developed a spreadsheet model to calculate the overall impact on Dutch gross domestic product and government debt, and compare them against what would otherwise happen if the Netherlands remains in the European Union.

For NExit, which is assumed to be announced on 1 January 2015, we consider three different potential future trade relationships between the Netherlands and the European Union:

- 'EFTA + bilateral', which is akin to the current Swiss relationship
- 'EEA', which assumes the Netherlands joins the European Economic Area and has a relationship with the bloc like Norway's
- 'WTO', which assumes that no withdrawal agreement can be negotiated and future trading relations are based on World Trade Organisation rules

We compare these different NExit outcomes with two baseline scenarios that assume continued membership of the union, as presented in Chapter 2:

- 'No further periphery support', whereby the Netherlands remains a member of the European Union and the level of future support it provides to heavily indebted peripheral states is limited to its current commitments within the European stability mechanism
- 'Periphery fully supported', whereby the Netherlands contributes with other core countries to reduce peripheral public debt levels to the current euro-zone average

(Our assumptions are tabulated in the appendix.)

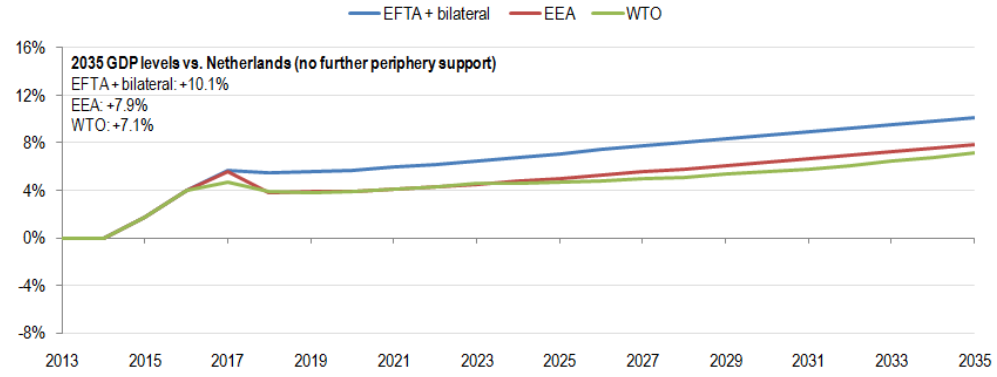
15.1 Central findings

Regardless of the outcome of any Netherlands-European Union trade negotiations and using our cautious but realistic assumptions, we find that Dutch gross domestic product is improved by withdrawing from the bloc, and especially so if further support is to be given by members to peripheral

countries. Under these assumptions the Dutch economy initially benefits from monetary and fiscal stimuli, and once these are scaled back, the other benefits of exit continue to build over time. (See Figure 109 and Figure 110.)

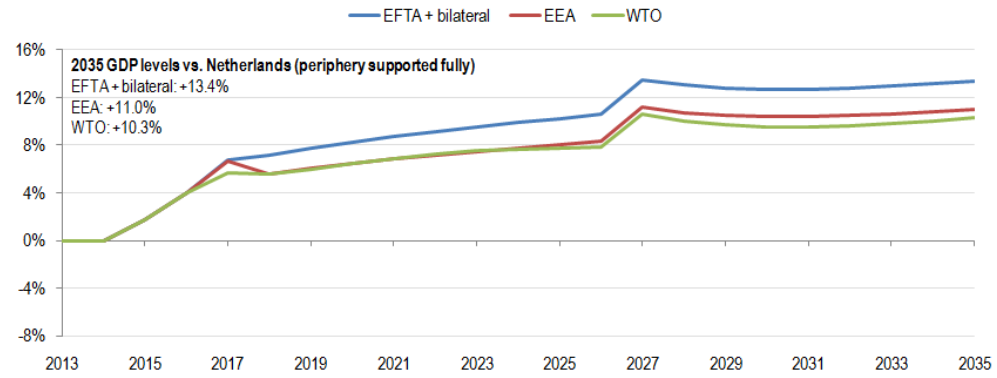
There are merits to a well negotiated withdrawal agreement. A Swiss-type relationship, where the Netherlands negotiates bespoke bilateral trade arrangements with Brussels, yields the greatest benefit with gross domestic product estimated to be 10.1 per cent higher than the no further periphery support baseline by 2035, and 13.4 per cent higher if the periphery is fully supported. Membership of the European Economic Area yields slightly lower benefits of 7.9 per cent and 11.0 per cent, and the equivalents are 7.1 per cent and 10.3 per cent for a World Trade Organisation relationship.

Figure 109: Percentage difference in gross domestic product vs. no further periphery support scenario



Source: Capital Economics

Figure 110: Percentage difference in gross domestic product vs. periphery fully supported scenario



Source: Capital Economics

By 2035, we calculate that across the 21 years NExit could add an accumulated €1,120 billion to Dutch gross domestic product in today's prices – even assuming that there are no further bailouts for peripheral nations. This is equivalent to €7,100 per household each year. Over this period, just under

one-third of the cumulative economic benefit arises from improved macroeconomic policy during the current crisis, a similar amount from reduced regulatory burdens and another third from reduced contributions to Brussels' coffers and immigration. (See Figure 111.)

It is a starker picture if the indebted peripheral states are bailed out fully by core countries like the Netherlands, with the accumulated benefits of NExit rising to an estimated €1,550 billion over the first 21 years – equivalent to €9,800 per household per year.

But the benefits of NExit start accruing immediately, especially if monetary and fiscal stimuli are deployed as we believe they should be. Under our 'No further periphery support' scenario, gross domestic product will be 6.8 per cent higher than it would have otherwise been after ten years, while in our 'periphery supported fully' scenario, it would be 9.9 per cent higher.

Figure 111: Cumulative gross domestic product impact of individual elements of 'NExit' by 2035, € billions (2013 prices)

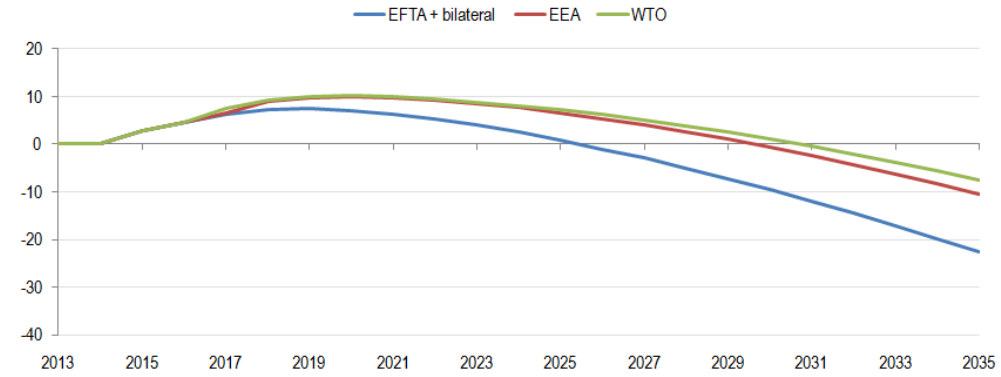
	'EFTA + bilaterals' with 'No further periphery support'	'EFTA + bilaterals' with 'Periphery supported fully'
Transition and ongoing currency transaction costs	-52	-52
Public finances	240	240
Macroeconomic policies	309	309
Immigration	163	163
Regulation	326	326
Trade	66	66
Inward investment	69	69
Bailouts of peripheral and other distressed euro-zone economies	-	426
Total	**1,121**	**1,547**

Source: Capital Economics

We have also modelled the potential impact on the ratio of government debt to gross domestic product. Our assumption of a fiscal stimulus after NExit means that initially the debt ratio will increase against what would otherwise happen if the Netherlands remains in the European Union. But over time higher growth helps bring the burden down.

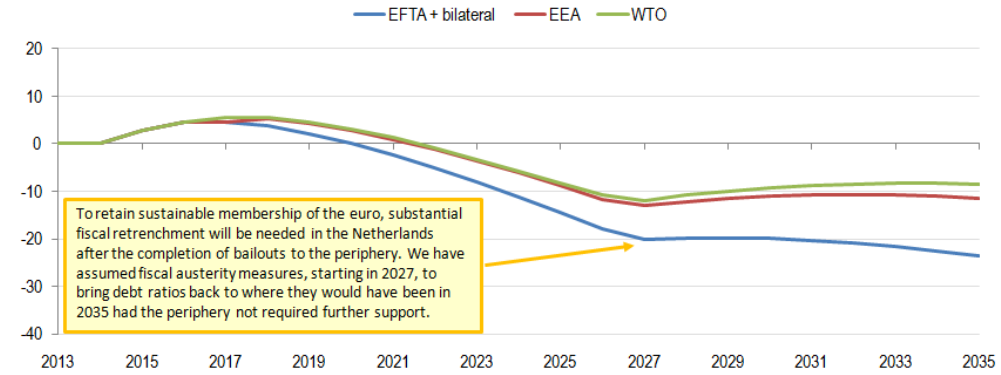
Depending on the outcome of any withdrawal agreement negotiations, we calculate that by 2026 the debt ratio will be lower outside the European Union than in – even assuming no further peripheral bailouts. The benefit to the debt ratio could come even faster if the Mediterranean states need more support. (See Figure 112 and Figure 113.)

Figure 112: Percentage points difference in the ratio of government debt to gross domestic product vs. no further periphery support scenario



Source: Capital Economics

Figure 113: Percentage points difference in the ratio of government debt to gross domestic product vs. periphery fully supported scenario



Source: Capital Economics

15.2 Stress tests

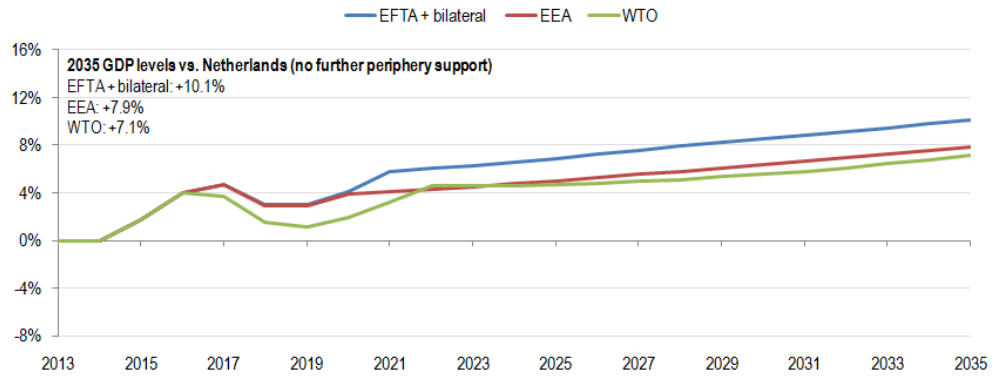
We have also tested the robustness of our findings by examining their sensitivity to changes in our underlying (already cautious) assumptions. There are four tests.

The first assumption to test is the timing of the longer-term benefits of NExit, especially reduced costs of regulation and any impacts on the levels of foreign direct investment.

We have recalculated the overall impact of NExit based upon these benefits starting to accrue three years later than we believe is cautiously realistic (but we leave the timing of any costs unchanged). Even with these delays to the impact of renationalising business regulation and inward investment, NExit remains an overall benefit from the first year. (See Figure 114.)

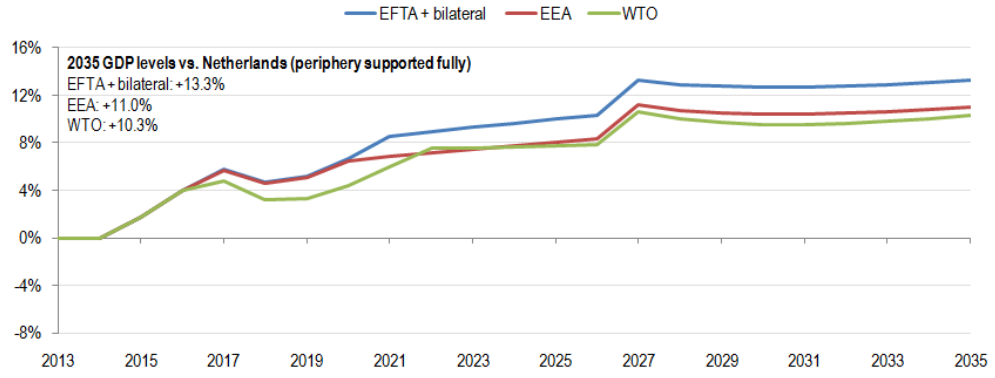
Figure 114: Delaying the longer-term benefits

(a) Percentage difference in gross domestic product vs. no further periphery support scenario



Source: Capital Economics

(b) Percentage difference in gross domestic product vs. periphery fully supported scenario



Source: Capital Economics

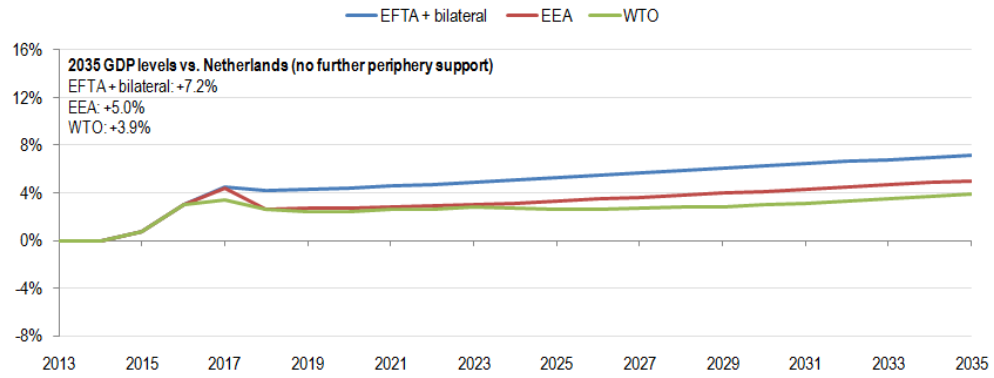
The second assumption to test is our choice of fiscal multipliers, which determine the impact of any change in net government expenditure on gross domestic product.

In our stress test, we recalculate assuming that nothing can have a multiplier greater than one or an impact in more than one year. Moreover, we reduce our already conservative 'normal' fiscal multiplier of 0.65 to 0.2.

By cutting the value of the multiplier in our calculations, we reduce the near term effectiveness of the fiscal freedoms to tackle the current economic crisis and the longer–term benefit of lower contributions to Brussels' coffers, but even so the NExit trajectory quickly becomes superior to staying in the European Union and delivers material benefits in the medium term. As such, our overall findings are not sensitive to our choice of multipliers. (See Figure 115.)

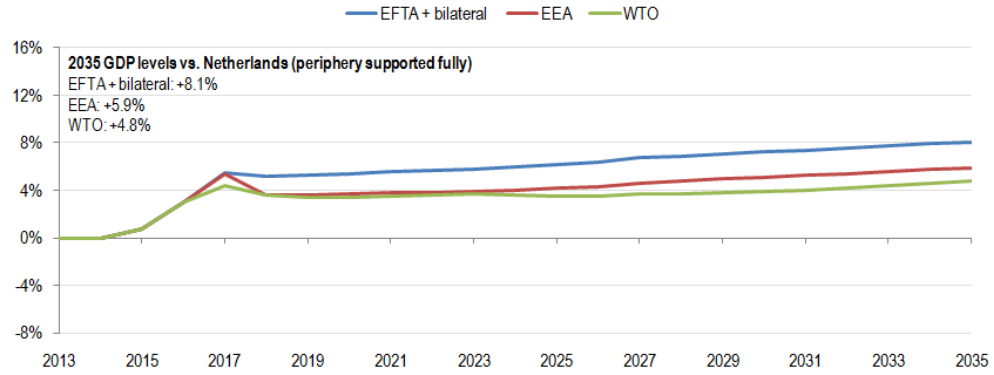
Figure 115: Lower fiscal multipliers

(a) Percentage difference in gross domestic product vs. no further periphery support scenario



Source: Capital Economics

(b) Percentage difference in gross domestic product vs. periphery fully supported scenario



Source: Capital Economics

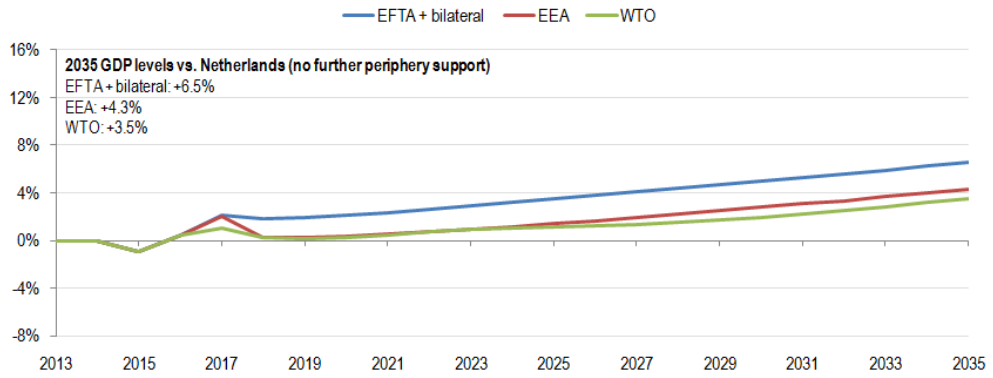
The third assumption to test is the valuation of the new guilder against the euro.

Here, we test a scenario whereby the guilder appreciates permanently by ten per cent against the euro. Dutch exporters lose market share, and pension funds see a reduction in their foreign incomes. (Although equally probable, we do not test a permanent depreciation as this would show a further increase in the benefits from NExit.)

These factors push Dutch gross domestic product below what it would be in our central scenario, but even so from 2016 onwards the Netherlands remains better off outside the European Union. (See Figure 116.)

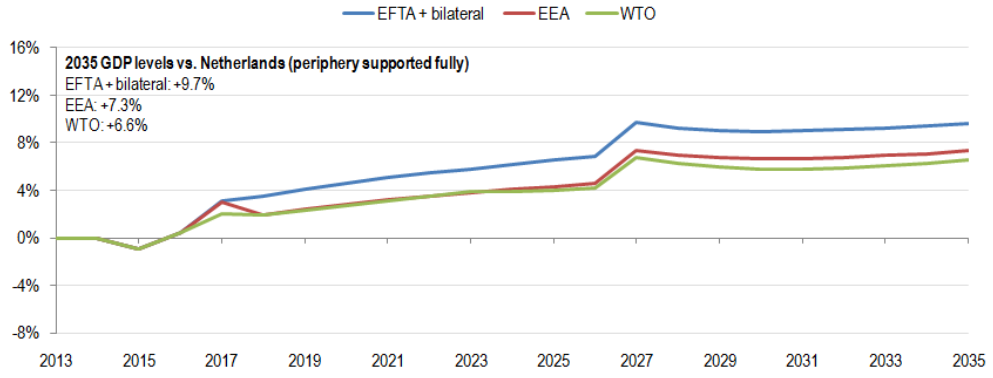
Figure 116: Permanent ten per cent appreciation

(a) Percentage difference in gross domestic product vs. no further periphery support scenario



Source: Capital Economics

(b) Percentage difference in gross domestic product vs. periphery fully supported scenario



Source: Capital Economics

Finally, we test our assumptions relating to the costs and impacts of transition.

In Part II, we find that the costs of transition are likely to be relatively small and that NExit is unlikely to have a material impact on sovereign debt costs, banking stability or pension funding. However, some commentators may believe that we are wrong – and argue that we have underestimated the potential for withdrawal from both the single currency and the political union to destabilise the economy.

But even if there is substantial destabilisation of the economy in the short and medium term, the longer term benefits of NExit will soon out-weigh them.

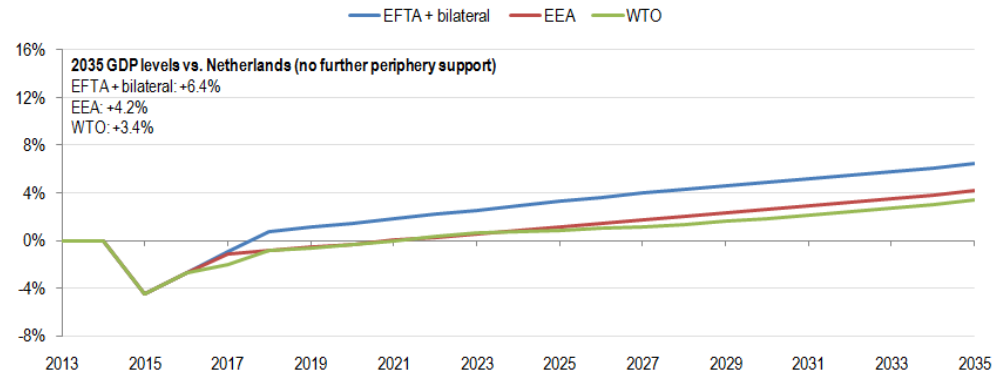
We have computed an extreme stress test to demonstrate this. The test assumes that the disruption of NExit creates in one single year a recession as deep as the entire fall seen in Dutch annual gross domestic product from peak

to trough since 2008. Indeed, to make the test even tougher, we assume that there is no post-NExit fiscal stimulus package in response. In the initial years, national income will be lower outside of the European Union than it would have been in. But over time, the benefits accumulate so that by 2018 the Netherlands is better off with NExit (in the 'EFTA + bilateral' scenario). By 2035, gross domestic product would be 6.4 per cent higher under a Swiss-type arrangement than within a union that hasn't even had to bailout the periphery further. (See Figure 117.)

Of course, no sensible commentator can believe that withdrawal from the union can be as disruptive as the aftermath of the collapse of Lehman Brothers in September 2008 and Netherlands' deepest recession in modern history. But, even if they do, their arguments for staying in the union are short-lived.

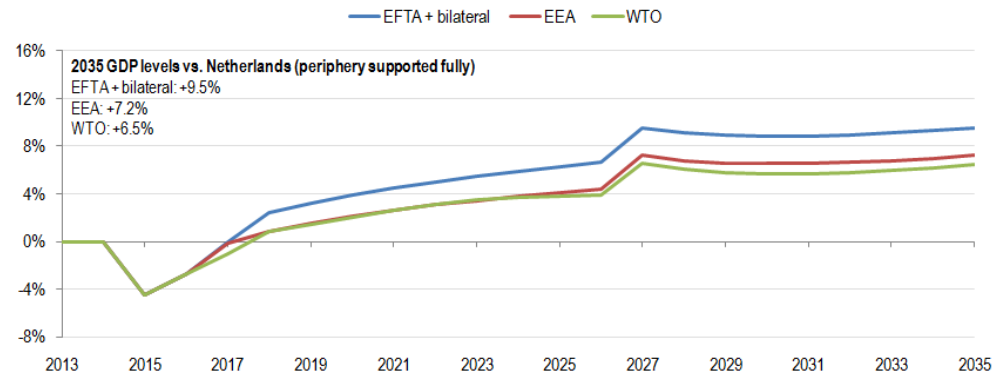
Figure 117: Initial crisis equivalent to the post-2008 recession

(a) Percentage difference in gross domestic product vs. no further periphery support scenario



Source: Capital Economics

(b) Percentage difference in gross domestic product vs. periphery fully supported scenario



Source: Capital Economics

Conclusion

The economic and policy freedoms, especially in the longer-term, that an exit from the European Union will give Dutch policymakers, will provide an opportunity for the Netherlands to see again rates of growth in prosperity that have looked otherwise consigned to distant history. Indeed, a NExit may even offer a more immediate fillip to an economy currently in crisis as monetary policy levers can be pulled in Amsterdam, rather than Frankfurt, and Brussels-inspired fiscal austerity can be recalibrated to Dutch and not German needs.

In this report, we make estimates of the scale of the various potential benefits (and costs) of NExit for the Dutch economy. But, of course, economics is far from an exact science and predictions of these types are used to show the broad scale and direction of impacts. The specific estimates presented herein should be viewed in this context, although we have systematically erred on the side of caution and used conservative estimates of the benefit of NExit.

When adding the impacts of the various elements of NExit together we can comfortably conclude that a well-executed NExit should deliver sustained higher rates of growth in Dutch gross domestic product than remaining within the bloc, and that these benefits are significant.

By 2035, a Swiss-type trading arrangement between the Netherlands and the European Union should see Dutch gross domestic product somewhere between ten and thirteen per cent higher than it would have been had the Netherlands continued as a member of the Brussels-led bloc. Over that 21 year period, the benefits of NExit to Dutch national income would have accumulated to between €1,100 and 1,500 billion in today's prices.

The profile of the overall benefit changes over time, with the fiscal and monetary stimulus adding most to growth in the short term and European Union budget savings and improvements to the business environment adding the most in the long term. Meanwhile, we have stress tested our key assumptions, and find our broad conclusions robust.

There are, of course, risks to leaving the union – and these need to be recognised and addressed by anyone considering NExit. But there are also significant risks to staying in a bloc with a fundamentally flawed currency and transfers to debt-laden peripheral states spiralling out of control. In this instance, our analysis shows that the Netherlands is not better off with the devil it knows, but by taking control of its own economic destiny.

APPENDIX: MODEL SPECIFICATION

Table 19: Historical data (2010-12) in the underlying model

Item	Source
Real gross domestic product	Eurostat
Nominal gross domestic product	Eurostat
Consumption	Eurostat
Exports	Eurostat
Imports	Eurostat
Change in stocks	Statistics Netherlands, Datastream
Investment	Statistics Netherlands, Datastream
Public debt	Eurostat
Government interest payments	Eurostat
Total government expenditure	Eurostat
Total government revenue	Eurostat
Government capital formation	Eurostat
Government consumption	Eurostat
Transfer payments	Capital Economics analysis

Source: Capital Economics

Table 20: Data assumptions (post 2012) in the underlying model

Item	Details	Source
Real gross domestic product growth	Long term growth rate for 2020-35 at 1.6%	Capital Economics
Gross domestic product deflator	•2013-18: International Monetary Fund forecast •2019-35: Capital Economics forecast	International Monetary Fund World Economic Outlook April 2013, Capital Economics
Net exports as share of gross domestic product	Weighted average of Capital Economics and Organisation for Economic Cooperation and Development. Decreasing weight applied to Capital Economics over time	Organisation for Economic Cooperation and Development Economic Outlook June 2013, Capital Economics
Government revenue as share of gross domestic product	•2013-18: International Monetary Fund forecast •2019-35 Assume figure remains at 2018 forecast value	International Monetary Fund World Economic Outlook April 2013
Government deficit as share of gross domestic product	Constant -0.5% from 2026	Capital Economics
Government transfers as share of gross domestic product	Decreasing over time as economy strengthens, and then increasing as population ages	Capital Economics
Interest rates	Rising to 5.0% in 2026 and then constant	Capital Economics
Government real consumption growth	From 2021, same as real gross domestic product growth	Capital Economics
Government nominal capital formation growth	From 2022, same as gross domestic product deflator growth	Capital Economics

Source: Capital Economics

Table 21: Data assumptions (post 2012) in the underlying model

	Real GDP growth	GDP deflator change	Net exports as share GDP	Government revenue as share GDP	Government deficit as share GDP	Government transfers as share GDP	Interest rates	Government real consumption growth	Government nominal capital formation growth
2013	-1.2%	2.8%	11.5%	46.8%	-3.5%	18.1%	2.6%	-0.9%	-4.0%
2014	0.5%	1.5%	12.4%	46.4%	-3.0%	17.7%	2.6%	-1.0%	-4.0%
2015	1.0%	2.0%	12.7%	46.3%	-1.5%	16.7%	2.6%	-0.4%	-3.5%
2016	1.5%	1.3%	12.0%	46.2%	-1.5%	16.6%	3.0%	1.0%	-3.5%
2017	2.0%	1.3%	11.1%	46.1%	-1.5%	16.4%	3.5%	1.1%	1.3%
2018	2.3%	1.3%	10.4%	46.1%	-1.3%	16.3%	3.8%	1.5%	1.3%
2019	2.0%	1.5%	9.6%	46.1%	-1.2%	16.2%	4.0%	1.8%	1.5%
2020	1.6%	1.5%	8.6%	46.1%	-1.1%	16.0%	4.2%	1.7%	1.5%
2021	1.6%	1.7%	7.8%	46.1%	-1.0%	15.8%	4.5%	1.6%	1.5%
2022	1.6%	2.0%	7.2%	46.1%	-0.9%	15.7%	4.6%	1.6%	2.0%
2023	1.6%	2.0%	6.7%	46.1%	-0.8%	15.7%	4.7%	1.6%	2.0%
2024	1.6%	2.0%	6.3%	46.1%	-0.7%	15.6%	4.8%	1.6%	2.0%
2025	1.6%	2.0%	5.9%	46.1%	-0.6%	15.6%	4.9%	1.6%	2.0%
2026	1.6%	2.0%	5.5%	46.1%	-0.5%	15.5%	5.0%	1.6%	2.0%
2027	1.6%	2.0%	5.2%	46.1%	-0.5%	15.6%	5.0%	1.6%	2.0%
2028	1.6%	2.0%	4.9%	46.1%	-0.5%	15.7%	5.0%	1.6%	2.0%
2029	1.6%	2.0%	4.6%	46.1%	-0.5%	15.8%	5.0%	1.6%	2.0%
2030	1.6%	2.0%	4.4%	46.1%	-0.5%	15.9%	5.0%	1.6%	2.0%
2031	1.6%	2.0%	4.1%	46.1%	-0.5%	16.0%	5.0%	1.6%	2.0%
2032	1.6%	2.0%	3.8%	46.1%	-0.5%	16.1%	5.0%	1.6%	2.0%
2033	1.6%	2.0%	3.6%	46.1%	-0.5%	16.2%	5.0%	1.6%	2.0%
2034	1.6%	2.0%	3.6%	46.1%	-0.5%	16.3%	5.0%	1.6%	2.0%
2035	1.6%	2.0%	3.6%	46.1%	-0.5%	16.4%	5.0%	1.6%	2.0%

Source: Capital Economics

Table 22: Assumptions in periphery fully supported

Item	Details	Source
Bailouts to periphery	• Annual direct bailouts of €7.36 billion from 2017 to 2026 (2013 prices) • Half financed by cut in domestic government spending, which is then transferred to periphery • Half financed by increase in government borrowing • Costs to the economy assumed to be 50% greater to reflect extra bailouts to the private sector • Modelled as reduced leakage of national income as this spending is a deadweight loss to the Dutch economy • After 2027 there are spending cuts equivalent to €36 billion a year (2013 prices) to bring debt levels down – the multipliers applied are the same as outlined in the fiscal stimulus item	Capital Economics

Source: Capital Economics

Table 23: Common assumptions in 'NExit' scenarios

Item	Details	Source
Monetary policy	• 2016: 1.0% GDP • 2017 to 2020: 2.0% GDP • After 2020 this declines to 1.0% GDP by 2035	Capital Economics
Fiscal stimulus	• 2015, 2016, 2017: 2.0% GDP • 2018 and beyond: This declines by ¼ each year • 'Crisis' fiscal multipliers used before 2018 • 'Normal' fiscal multipliers used after 2018 • 'Crisis' multipliers: Year 1: 1.5 • 'Normal' multipliers: Year 1: 0.65	Capital Economics
Reduced foreign leakage	• Year 1: multiplier of 1 • This then declines each year by 28.5% as money leaks outside of the economy	Capital Economics
Immigration	• Present value savings of €4.0 billion each year (2013 prices) • Immigration increases by 3.1% each year (average of annual increase between 2003 and 2012) • Extra government spending modelled using composite of reduced foreign leakage and fiscal stimulus multipliers	Capital Economics, Nyfer
Structural revaluation	• 0% estimated	Capital Economics
Long term currency repositioning	• None calculated	Capital Economics
Currency transaction costs	• -0.3% GDP each year	Capital Economics
Transition costs associated with moving to new currency	• -0.5% GDP in 2015	Capital Economics
Short term banking sector impact	• -0.5% GDP in 2015 (assumed impact of six months of volatility)	Capital Economics

Source: Capital Economics

Table 24: EFTA + bilateral assumptions

Item	Details	Source
Public finances (European Union budget savings)	• 2015: zero • 2016: 0.34% GDP net savings. Netherlands finances current European Union spending in the Netherlands, Dutch stop making VAT and GNI based contributions, but as European Union trade policy still applies they continue to make contributions from sugar levies and import duties • 2017 and beyond: 0.45% GDP net savings. European Union treaties no longer apply, Netherlands removes all import tariffs and therefore no longer receives revenue from import duties. After 2021 this increases to 0.55% GDP due to expiry of the Dutch rebate • The savings are used as extra spending in the Dutch economy • The fiscal multipliers for this extra government spending are the same as outlined in the 'reduced foreign leakage' item • 2017 and beyond: 20% of the spending that was carried out under EU programmes in the Netherlands is spent more efficiently by the Dutch government. Multipliers attached to this are outlined in 'fiscal stimulus'	Capital Economics analysis of Swiss arrangements and European Union budget
Regulation	• 2015/16: zero (EU treaties apply) • 2017: 25% of EU regulation is renationalised • 2018 and beyond: An additional half of the remaining 75% is renationalised	Capital Economics
Globalisation	• 2015/16: No trade effects as EU treaties and trade policies still apply • 2017 and beyond: initial costs as rules of origin imposed on Dutch exports, benefit by 2025 due to shift in share of exports to faster growing emerging economies	Capital Economics
Inward investment	• 2015/16: No effects as EU treaties still apply • 2017 and beyond: Netherlands gradually increases share of world greenfield investment towards Dutch share of world GDP. This is capped to only close half of the gap. Global greenfield investment is assumed to increase in line with OECD global growth forecasts	Capital Economics, Organisation for Economic Co-operation and Development

Source: Capital Economics

Table 25: EEA assumptions

Item	Details	Source
Public finances (European Union budget savings)	• 2015: zero • 2016: 0.34% GDP net savings. Netherlands finances current European Union spending in the Netherlands, Dutch stop making VAT and GNI based contributions, but as European Union trade policy still applies they continue to make contributions from sugar levies and import duties • 2017 and beyond: 0.40% GDP net savings. European Union treaties no longer apply, Netherlands removes all import tariffs and therefore no longer receives revenue from import duties. After 2021 this increases to 0.50% GDP due to expiry of the Dutch rebate • The savings are used as extra spending in the Dutch economy • The fiscal multipliers for this extra government spending are the same as outlined in the 'reduced foreign leakage' item • 2017 and beyond: 20% of the spending that was carried out under EU programmes in the Netherlands is spent more efficiently by the Dutch government. Multipliers attached to this are outlined in 'fiscal stimulus'	Capital Economics analysis of Norwegian arrangements and European Union budget
Regulation	• 2015/16: zero (EU treaties apply) • 2017: 25% of EU regulation is renationalised • 2018 and beyond: assume benefits of the 25% regulation renationalisation each year	Capital Economics
Globalisation	• 2015/16: No trade effects as EU treaties and trade policies still apply • 2017 and beyond: initial costs as rules of origin imposed on Dutch exports, benefit by 2025 due to shift in share of exports to faster growing emerging economies	Capital Economics
Inward investment	• No impact on inward investment in EEA scenario	Capital Economics

Source: Capital Economics

Table 26: WTO assumptions

Item	Details	Source
Public finances (European Union budget savings)	• 2015: zero • 2016: 0.34% GDP net savings. Netherlands finances current European Union spending in the Netherlands, Dutch stop making VAT and GNI based contributions, but as European Union trade policy still applies they continue to make contributions from sugar levies and import duties • 2017 and beyond: 0.55% GDP net savings. European Union treaties no longer apply, Netherlands removes all import tariffs and therefore no longer receives revenue from import duties. After 2021 this increases to 0.65% GDP due to expiry of the Dutch rebate • The savings are used as extra spending in the Dutch economy • The fiscal multipliers for this extra government spending are the same as outlined in the 'reduced foreign leakage' item • 2017 and beyond: 20% of the spending that was carried out under EU programmes in the Netherlands is spent more efficiently by the Dutch government. Multipliers attached to this are outlined in 'fiscal stimulus'	Capital Economics analysis of European Union budget
Regulation	• 2015/16: zero (EU treaties apply) • 2017: 25% of EU regulation is renationalised • 2018 and beyond: Full renationalisation of EU regulation	Capital Economics
Globalisation	• 2015/16: No trade effects as EU treaties and trade policies still apply • 2017 and beyond: initial costs as rules of origin imposed on Dutch exports, although shift in share of exports to faster growing emerging economies, cumulative impact is still negative in 2035	Capital Economics
Inward investment	• 2015/16: No effects as EU treaties still apply • 2017 and beyond: Netherlands does not increase share of greenfield investment and does not get the share of the growth in investment each year that would come from EU countries. The greatest additional impact comes in 2017 but this is then reduced out to 2035 as investors adjust to new trading relationships and renationalised regulation	Capital Economics

Source: Capital Economics

Table 27: Sensitivity testing assumptions

Item	Details	Source
Delayed inward investment and regulation benefits	• Regulation benefits start in 2020 not 2017 • Inward investment benefits in 'EFTA + bilateral' start in 2020 not 2017 • Inward investment effect (zero) in 'EEA' and negative effects (start 2017) in 'WTO' are unchanged from central scenario	Capital Economics
Low fiscal multipliers	• Multipliers in year one only • 'Crisis' multiplier set to 1.0, 'reduced foreign leakage' multiplier set to 1.0, 'normal' multiplier set to 0.2	Capital Economics
Permanent 10% appreciation	• -2.7% on GDP in each year based on net exports impact • -0.9% on GDP in each year based on pensions impact • +0.5% GDP due to short term banking gain in 2015	Capital Economics
Permanent effect of -3.7% GDP recession in 2015, no fiscal stimulus	• Recession of -3.7% in 2015 and this is a permanent decrease in level of GDP through to 2035 • No fiscal stimulus is applied	Capital Economics

Source: Capital Economics

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