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Causes of Recent Balance of Payments Deterioration in the Netherlands
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CAUSES OF RECENT BALANCE OF PAYMENTS

DETERIORATION IN THE NETHERLANDS

Robert Solomon

The foreign trade position of the Netherlands, which had improved markedly during 1949, deteriorated again in 1950. The merchandise trade deficit, in terms of guilders, increased from 1,485 to 2,465 million guilders or 66 percent from 1949 to 1950, and the percentage of imports covered by exports fell from 72 in 1949 to 68 in 1950.

This development, which led the Government to announce several months ago that the balance of payments deficit would approach 1 billion guilders in 1950 compared with less than 200 million guilders in 1949, has had a number of important political and economic repercussions. The resignation of the Dutch Government, the long delay in forming a new one, and the postponement of the signature of the Benelux Economic Treaty are but a few of the events for which the increased trade deficit has been held partly responsible.

Because of the importance of these issues, there has been considerable discussion in the Netherlands, in Belgium, and elsewhere concerning the responsibility for the increased deficit. It has been argued in some quarters, especially in Belgium, that the Netherlands is still experiencing repressed inflation and what is needed is a more disinflationary fiscal policy together with a more stringent monetary policy. In the Netherlands it has been frequently argued that the combined affects of declining terms of trade and trade liberalization have been responsible for the increased trade gap. In particular the freeing of over 90 percent of (1948) imports from Belgium is singled out as a primary cause for the increased deficit because the rise in the deficit with Belgium accounts for almost half of the increase in the deficit with all countries.

## The Dutch position at the end of 1949

By the end of 1949, the level of industrial production had risen to 137 percent of 1938, and the outlook for continued progress in recovery was very favorable. Most of the direct controls under which the economy had operated since the end of the war had been removed. Subsidies had been reduced and coffee was the only consumer good still being rationed. It appeared that the condition of repressed inflation had been worked off since the removal of controls did not result in a surge of consumer purchases. Under these conditions the Netherlands was prepared to join in the OEEC effort to reduce trade barriers within Europe. The Netherlands removed restrictions on 50 percent (and later 60 percent) of its 1948 imports from the other participating countries and, in particular, on over 90 percent of its imports from Belgium - Luxembourg.

The balance of payments position of the Netherlands in 1949 reflected the other favorable developments in the economy. The percentage of imports covered by exports rose from 54 percent in 1948 to 72 percent in 1949. The balance payments deficit on current account fell from over 1,100 to less than 200 million guilders. While this sharp drop was abnormal in that it included a number of extraordinary receipts, it nevertheless gave rise to considerable, and for the most part justified, optimism regarding the degree of recovery.

Prices in the Netherlands, which had been relatively stable, began to rise rather sharply at the end of 1949 under the impact of devaluation, price developments abroad, and reduced subsidies. As a result, wages, which had previously kept pace with the cost of living, began to lag. Despite two 5 percent wage increases in January and September 1950 this lag has persisted.

Trade deficit in 1950

In 1950 the trade deficit amounted to 2,465 million guilders, compared with 1,485 million guilders in 1949. While it is true that the deficit, in terms of guilders, has increased by 2/3, it must be recognized that this increase is not as serious as it appears, because of the lowering of the value of the guilder in 1949. 1/ If the deficits of 1949 and 1950 are converted into dollars 2/ the following figures are obtained:

| | Millions of Guilders | Percent Change | Millions of Dollars | Percent Change |
|---|---|---|---|---|
| 1948 | 2,240 | | 845 | |
| | | -34 | | -40 |
| 1949 | 1,485 | | 505 | |
| | | +66 | | +29 |
| 1950 | 2,465 | | 649 | |

While the deficit did increase even in terms of dollars, the extent of this rise was considerably less. To the extent that the Netherlands finds it necessary to cover its deficits in dollars,- and with the introduction of the European Payments Union this is becoming increasingly true,- this type of calculation measures the drain on Dutch reserves or the need for foreign aid.

1/ After devaluation, it is possible for a country's deficit in domestic currency to rise while its deficit expressed in foreign currency declines. See Albert O. Hirschman, "Devaluation and The Trade Balance", Review of Economics and Statistics, February, 1949.

2/ Three-fourth's of the 1949 deficit at the pre-devaluation exchange rate of 2.65 guilders per dollar and one-fourth at the current rate of 3.80 guilders per dollar.

## Terms of trade

A major portion of the increased trade deficit can be explained by the deterioration of the terms of trade of the Netherlands from 1949 to 1950. While import prices, in terms of guilders, rose from an average of 96 (1948=100) in the first eleven months of 1949 to 107 in the same period of 1950, export prices rose only from 94 to 96. If the guilder values of imports and exports in 1950 are expressed in 1949 prices, it is found that the deficit rises from 1,364 million guilders in January - November 1949 to 1,677 million guilders in the same period of 1950 (see Table I). The deficit in current prices for the first eleven months of 1950 was 2,303 million guilders. Thus it may be said that two-thirds of the increase in the deficit is accounted for by price movements. In relative terms, the quantity of exports increased by slightly more (38 percent) than the quantity of imports (34 percent) from 1949 to 1950. But because exports in 1949 were only 72 percent of imports, this better relative showing of export volume would not have been sufficient to lead to a smaller deficit in absolute terms even in the absence of price changes.

Table I

Foreign Trade of the Netherlands
(Millions of guilders)

| | | January-November 1950 | |
|---|---|---|---|
| | January-November 1949 | Current Prices | 1949 Prices |
| Imports | 4,725 | 7,054 | 6,329 |
| Exports | 3,361 | 4,751 | 4,652 |
| Deficit | 1,364 | 2,303 | 1,677 |

Source: Central Bureau of Statistics and calculation by writer.

Of course, it must be recognized that the 30 percent devaluation of the guilder in September 1949 was largely, though not entirely, responsible for the change in the terms of trade. Furthermore, it might be argued that, had devaluation not occurred, the volume of exports would not have increased as much as it did. Thus the implication above that, in the absence of price changes, the deficit would have been only 1,677 million guilders, is arguable. It may be mentioned, however, that during 1949 exports from the Netherlands were increasing rapidly, and there was no talk of an independent devaluation of the guilder. Because of close ties to the sterling area the Netherlands, as a small country with a high dependence on foreign trade, found it advisable to follow along more or less reluctantly with devaluation.

## Consumption

The consumption data shown in Table II indicate that for the first ten months of the year 1950 the level of consumer expenditures in constant prices was identical with that of the previous year. 1/ The wave of buying that followed Korea, but apparently abated in October, was not of sufficient magnitude to raise the average for the year above that of 1949.

Table II

Relative Changes in Consumption and Imports

| | Consumer Goods Imports 1950÷1949 | Volume of Consumer Expenditures 1950÷1949 |
|---|---|---|
| January | n.a. | 98 |
| February | 160 | 98 |
| March | 160 | 97 |
| April | 192 | 96 |
| May | 185 | 104 |
| June | 126 | 99 |
| July | 136 | 103 |
| August | 164 | 102 |
| September | 204 | 113 |
| October | 183 | 91 |
| January-October | 163 | 100 |

Source: Calculated from indices published by Central Bureau of Statistics.

Table II compares the monthly changes in the volume of imports of consumer goods with the monthly changes in the volume of consumer purchases (in constant prices). That is, the percentage change from January 1949 to January 1950, and so on, in imports of consumer goods is compared with the similar ratios for quantity of consumption. It may be seen that while consumption remained unchanged over the ten-month period from one year to the next, imports of consumer goods increased by 63 percent. It can only be concluded that the additional consumer goods, or their home-produced equivalent, were added to inventories. 2/ It should be noted

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1/ Preliminary information from the Central Bureau of Statistics indicates that for the year as a whole the index stood at 104, compared with 105 in 1949.

2/ The possibility that some of the imported consumer goods were re-exported to Germany was examined. The following data for the year 1950 were derived from German trade statistics (millions of dollars):

| | |
|---|---|
| Total German imports from Netherlands - | 373 |
| German imports from Netherlands of Dutch-produced goods - | 296 |
| German imports from Netherlands of goods produced elsewhere - | 77 |
| German imports of Indonesian and Dutch West Indies goods from the Netherlands - | 58 |
| German imports from Netherlands of goods produced elsewhere than in Dutch monetary area - | 19 |

Imports of goods from the Dutch monetary area are deducted because all German imports from that area come through the Netherlands. Furthermore, they apparently do not enter Dutch trade statistics. Finally the commodities involved are probably not consumer goods anyway.

Thus at the very most, the re-export to Germany of imported consumer goods amounted to $19 million or 72 million guilders. The increase of consumer goods imports in 1950 over 1949 was about 300 million guilders. Source: Der Aussendhandel der Bundesrepublik Deutschland, December 1950.

that this development occurred fairly evenly over the entire year and is not especially attributable to panic or speculative importing during the second half of the year.

It was noted earlier that, in 1949 prices, the deficit increased by 313 million guilders from the first eleven months of 1949 to the first eleven months of 1950. It is possible to calculate the value, in 1949 prices, of the increase in the importation of consumer goods over the same period. This turns out to be 212 million guilders. 1/ Since we know that in terms of aggregates most of the increase in consumer goods imports was stocked, we may say that of the increase in the deficit in constant prices one-half to two-thirds was due to inventory accumulation.

The possibility must be considered that all of the increase in consumer goods imports was purchased by consumers and that an equivalent amount of domestic goods was stocked. That is, with the reduction in import barriers after so many years, the Dutch population might have shown a preference for foreign goods with the result that domestic producers found themselves with unsold goods which they unvoluntarily added to stock. While this interpretation cannot be entirely disregarded, it may be noted that the production of consumer goods continued to rise during 1950. Since such a switching of consumer purchases would have resulted in an actual decline in the demand for domestic production, it seems reasonable to assume that this phenomenon did not play an important role in 1950.

Production and raw material imports

There is evidence that not only consumer goods but also raw materials were imported and stocked. While the level of industrial production increased from 125 to 140 (1938=100) from 1949 to 1950

1/ The published foreign trade statistics of the Netherlands do not normally show a breakdown giving consumer goods separately, although volume and prices indices of this classification of imports is presented regularly. The value of consumer goods imports for 1948 is available, however, in a study presenting the basis for the calculation of the volume and price indices. (Statistiche en econometrische onderzoekingen /Statistical and Econometric Studies/ June 1949, Central Bureau of Statistics). Taking this figure for consumer goods imports in 1948 (320 million guilders) and using the volume and price series, one can calculate changes in the value of consumer goods imports.

(first eleven months) or by 12 percent, the volume of raw materials imports increased by 36 percent over the same period. 1/

Investment

Data on investment are not yet available in sufficient detail to permit a judgment as to its influence. Net investment (including inventory accumulation) amounted to 2,100 million guilders in the first half of 1950 compared with 1,500 million guilders in the same period of 1949. Although the published data do not show inventories separately, our previous analysis leads to the conclusion that part of the increase is ascribable to the stocking of imported goods. In addition it is likely that home-produced goods were stocked during the year. It is thus possible that there was very little increase in fixed investment. In this connection, it is significant to note that the volume of imports of investment goods increased by only 7 percent from 1949 to 1950, and that this increase occurred after Korea.

Reasons for deterioration

From the data presented above, certain general conclusions can be drawn as to the nature of developments in the economy of the Netherlands during 1950. The sharp increase in the trade deficit is mainly accounted for by the fact that import prices, in terms of guilders, rose by more than export prices. However, roughly one-third of the increase in the deficit may be ascribed to real factors. While export volume increased more, in relative terms, than import volume, the absolute increase in exports (in 1949 prices) was less than that in imports. While the rate of increase in export volume declined (50 percent from 1948 to 1949 and 38 percent from 1949 to 1950), import volume increased sharply (11 percent from 1948 to 1949 and 34 percent from 1949 to 1950).

It has been shown that of the remaining increase in the deficit, close to two-thirds is accounted for by imports of consumer goods for stock. Since it has also been shown that raw material inventories increased, it is likely that a good portion of the remaining unexplained deficit was accounted for by that factor.

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1/ These indices are not completely comparable because the import index includes agricultural raw materials, the increase for which was 59 percent from 1949 to 1950. A rough adjustment to eliminate agricultural raw materials, using the 1949 values of imports as weights, yields an increase in the volume of non-agricultural imports of 32 percent. A rough calculation, based on the assumption that raw material requirements from abroad increase proportionately with industrial production, indicates that the stocking of industrial raw materials may have been even more important than that of consumer goods.

The claim that the Netherlands is still suffering from repressed inflation is not borne out by the facts, if by repressed inflation is meant a condition in which consumers' demand is pressing against the available supply of goods but prices are restrained by controls. Actually most price controls had been lifted before Korea. Furthermore, the increased availability of consumer goods, as evidenced by the large imports unaccompanied by increased consumer takings, indicates that consumer incomes and liquid assets were not excessive.

Wages have lagged behind the rise in living costs since the fall of 1949. Moreover, on the basis of the above analysis, we have evidence that the liquid assets of consumers are not in excess of what they desire to hold in that form.

In general what appears to have happened in the Netherlands in 1950 has been a re-stocking of the economy with inventories of imports, especially of consumer goods but apparently also of raw materials. Except for one or two months during the summer, the process was not of the speculative kind. With the partial liberalization of intra-European trade, beginning in the autumn of 1949, and the much greater freeing of intra-Benelux trade, Dutch traders decided to replenish their stocks of foreign and perhaps also of domestic goods, which had been depleted during the war and the early postwar period of repressed inflation. 1/ While this process had begun in 1949 it appears to have accelerated sharply in 1950.

The question may be asked, how did Dutch businessmen finance this accumulation of inventories?

A partial explanation can be found in the expansion of bank credit which occurred in 1950. During the entire postwar period until last year, recourse to the banking system by the private economy had been quite insignificant. During the first nine months of 1949, credit to business and individuals increased by only 89 million guilders. During the first three quarters of 1950, however, the increase was 214 million guilders. It was this increase which led the Dutch monetary authorities in September to announce the initiation of a new system of quantitative credit controls effective January 1, 1951.

1/ In the year 1949 the volume of imports of consumer goods was only 50 percent of the 1938 level.

After September the amount of outstanding credit to the private economy declined, while consumer goods imports continued to exceed the volume of consumer purchases. For the first eleven months of 1950, bank credit to the private economy increased by 177 million guilders while inventories of consumer goods 1/ rose by 212 million guilders. Furthermore we know that inventories of imported raw materials also rose substantially. Thus, only a portion of the increase in imported inventories can be said to have been financed by bank credit. Presumably the remainder was financed from the current earnings and liquid assets of business.

## Implications for policy

The foregoing results indicate that the Dutch credit restrictions are likely to be directly effective in cutting down Dutch imports and the accumulation of stocks of imported goods. In fact, it is interesting to note that these restrictions hit directly at one of the causes for the trade deficit, in contrast to the usual situation where credit restrictions are relied upon to dampen the general level of demand and, as a result, to improve the trade balance.

It should also be noted, however, that not all the inventory accumulation was financed by bank credit. In view of the still large liquid assets and high earnings of Dutch tradesmen, recourse to taxation may also be necessary in arresting the accumulation of imported inventories.

It is clear that increasing consumption was not responsible for the deterioration of the foreign trade position. Thus, if fiscal policies designed to reduce consumption are decided upon, it should be with the knowledge that while such policies may help to improve the trade balance, they are not hitting the immediate causes of the deterioration.

On the other hand, it has been shown that the primary reason for the increased deficit is the worsening of the terms of trade. To adjust to this development, the level of consumption and/or investment will probably have to be restricted, especially when the rearmament program is initiated. But the continued rapid growth in Dutch output should be borne in mind in any evaluation of the adjustment required.

## Outlook

In the light of post-Korean economic developments throughout the world it may turn out that the decision of Dutch traders to increase inventories was, on the whole, a fortunate one for the Dutch economy. A temporarily increased deficit may in the future be considered to have been very much worth while, since it permitted stocks of raw materials and consumer goods to be replenished before a new period of scarcities and sharply rising prices. Furthermore, it is a process that is obviously temporary and self-terminating.

1/ That is, the increase in 1949 prices in consumer goods imports from 1949 to 1950. This difference is used as a measure of inventory accumulation of imported consumer goods, since the volume of consumer takings did not exceed that for 1949.

On the other hand, other serious problems face the Netherlands in its struggle to achieve balance in its foreign payments position. The dollar gap, while it has declined in recent months, is far from closed. The recent embargo on imports by the German authorities will have particularly serious repercussions in the Netherlands, for which Germany has again become the most important export market. The latter problem may well be the most serious preoccupation of the Dutch authorities in 1951.

Of course, the main cause for the deteriorating trade balance - the development of the terms of trade - is quite outside the control of the Dutch economy and, along with the rearmament effort, will be a factor requiring sacrifices in Dutch living standards or investment plans.