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den Butter, F.A.G.; Mosch, R.H.J.

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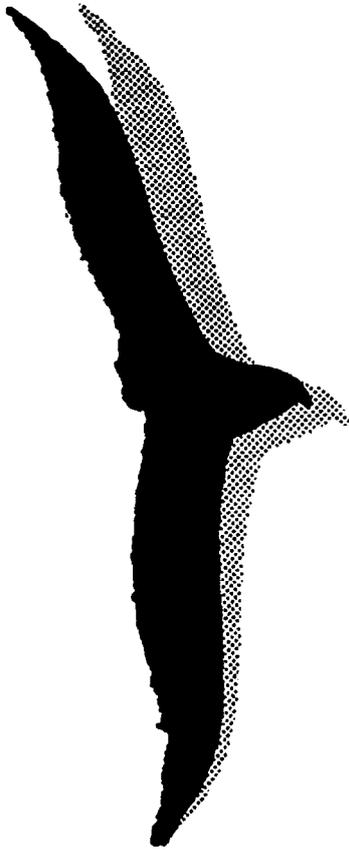
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Frank A.C. den Butter
Robert H.J. Mosch

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The Dutch miracle: institutions, networks and trust

Frank A.G. den Butter¹ and Robert H.J. Mosch²

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Abstract

Between 1982 and 2000, the Netherlands experienced a remarkable **economic** recovery. Labour participation rose **from** a European low of 52 percent to the European **average** of 65 percent. Unemployment decreased from a high of 14 percent to a present-day low of 2½ percent, while government **finances** and social security were reorganised. This paper aims to demonstrate **how** the Dutch culture of consensus, reflected in the Dutch institutional consultation structure, was one of the **main** driving **forces** of this recovery. The trust enhancing effects of the institutional framework, in which government, **unions**, employer organisations, central bank and advisory bodies meet **each** other **frequently** in formal and informal atmospheres, **produced** an environment of mutual trust and **co-operation** that was **capable** of effectively dealing with the problems. Two decades of wage moderation and increased labour market **flexibility** have led to **economic** prosperity without significant social unrest. It is an example of an institutional **framework** that transforms trust between **persons** and organisations at the **micro** level to positive macroeconomic effects.

Keywords: labour market policy, institutional framework, networks, trust

1. Introduction

Between 1982 and 2000, the Netherlands experienced a remarkable **economic** recovery. Some people even speak of a “Dutch miracle” and hold the so-called “Polder model” responsible. Highlights are the increase of labour participation **from** a by international standards relatively low 52 percent to the European **average** of 65 percent, and the decrease in unemployment **from** a high of 14 percent to a present-day low of 2% percent. Furthermore, government **finances** turned **from** a 9 percent deficit to a small surplus and the social security system was drastically reorganised.

Several explanations have been given for this **miraculous** recovery. This paper **focuses** on the role of the **specific** Dutch institutional framework of **social-economic** policy preparation as a driving force of the recovery. The Dutch culture of consensus **finding** in combination with the institutional consultation structure in which government, **unions**, employer organisations,

¹ Tinbergen Institute; Free University, Applied Labour Economics Research Team (ALERT), Department of Economics: De Boelelaan 1105, 108 1 HV Amsterdam, The Netherlands; **Scientific** Council for Government Policy, email: fbutter@econ.vu.nl.

² Tinbergen **Institute**; Free University, Applied Labour Economics Research Team (ALERT), Department of Economics: De Boelelaan 1105, 1081 HV Amsterdam, The Netherlands, email: mosch@tinbergen.nl.

central bank and advisory bodies meet **each** other **frequently** in formal and informal atmospheres, **produced** an environment of mutual trust and co-operation that was **capable** of effectively dealing with the problems of the **economy**.

The concept of trust becomes relevant for **economic** analysis **when** one drops the standard assumption of perfect and **free** information and takes **care** of the notion of bounded rationality. In a situation of imperfect and **asymmetric** information, which is typical for the policy **making** process, it is impossible to **write** complete and legally binding **contracts**. This offers the possibility of opportunistic behaviour by transaction partners. This **means** that agents **can** gain extra benefits at the expense of their transaction partners (Williamson, 1985). In these situations, trustworthiness is regarded as the characteristic of the party that refrains **from** opportunistic behaviour. Trust is the expectation of a party that the other party **will** behave trustworthy. It favours co-operation. The combination of game theory and the practical problem of **co-ordination** between different parties at the labour market shows that - in general - parties **will** be better off if they **co-ordinate policies** than they would be in the Nash uncooperative equilibrium in which **each** party sets its **policies** while taking those of the others as given.

A major advantage of **building** trust by co-operation of **unions** and employer associations is that hold-up problems **can** be prevented. Two decades of co-operation between **unions** and employer federations in the Netherlands have crystallised into a sustained **combined** strategy of lowering wage **costs**, increased labour market flexibility and investment in employment. Although this strategy involved twenty years of wage moderation (during which profits of **firms** were restored), **social** unrest in the form of strike activity has been negligible. Although wage moderation in The Netherlands **can** be seen as just the Phillips-curve effect in reaction to high unemployment, a major argument of our paper is that this sustained **co-operative** stance **can** only be explained in terms of high mutual trust between the negotiating parties of labour standards. The institutional **framework** **can** in this way be seen as the intermediary element that **transforms** trust between **persons** and organisations at the **micro** level (**often** found in microeconomic game experiments) to positive macroeconomic **effects**.

Yet, in spite of the enhanced labour participation, and in spite of various reforms of the **social** security system, **demand** for **social** security benefits remained high in the Netherlands, especially with respect to labour disability, **where** a **considerable** part of the receivers of benefits are unemployed in disguise. Hence, this outcome of the reforms in the **social** security system shows a remarkable discrepancy between the behaviour of **social** partners in the wage setting process and their management of **social** security. The **first** **can** be considered highly responsible and praiseworthy, the **second** is a **clear** example of rent-seeking behaviour. In the constellation **where** on the one hand **social** partners had to **decide** about the implementation of the **social** security system, and on the other hand government had to bear **all costs**, **social** partners **frustrated** the workings of the system by using it as a "dump" for less-productive workers. In that way they took no interest in the **costs** for society. This **may** be a lesson that a **co-operative** stance in one field of policy does not form a guarantee for joint utility maximising behaviour in other **fields**. The institutional **structure** must always be given the shape that internalises **all external effects** in the decision procedure.

The content of the paper is as follows. **Section 2** gives a short overview of the **main** characteristics of the transition **from** the Dutch disease to the Dutch miracle. The **main** institutions and their role in the "Polder" model are **discussed** in **section 3**. In this discussion, a special emphasis is laid on the trust enhancing **aspects** of this institutional **framework**.

Section 4 explains the **relevance** of trust for the **efficient** functioning of labour **markets** in some more detail. **After** the treatment of the theoretical model, we show the appropriateness of the model for the Dutch (labour) market. In section 5, we confront the **findings** of the earlier sections with the actual interaction of the policy makers in the Dutch institutional setting. The Wassenaar agreement and the **main** policy measures that are held responsible for the **economic** recovery are analysed in the light of trust between the **main** players and the theoretical model **discussed** in section 4. Section 6 concludes.

2. From Dutch disease to Dutch miracle

The **post-war** period until 1963 **can** be characterised by strong GDP growth, **full** employment and, because of government wage **control**, modest wage increases. **After** the period of reconstruction which ended in the mid 1950's the Dutch **economy** was characterised by former Minister Andriessen (1987) as an **economic** eldorado. It was a period of Keynesian **demand** management, with hardly **any** cyclical downturns.

The system of government wage **control** more or less stops functioning **after** 1963. This is **caused** by pressure **from** the market - **where** labour shortages lead to "black wages" - and **from** social partners (labour **unions** and employer associations) **who** want to stop government interventions in "their" labour market. The gradient release of wage setting **comes** at the same **time** with the transition to a modern welfare **state** by expanding **social** security with a number of provisions which, later, prove to be **very** generous (see table 1). The discovery and exploitation of large stocks of natural gas **contribute** to the political belief that **such** a generous and extensive system is sustainable and **can** be **financed**.

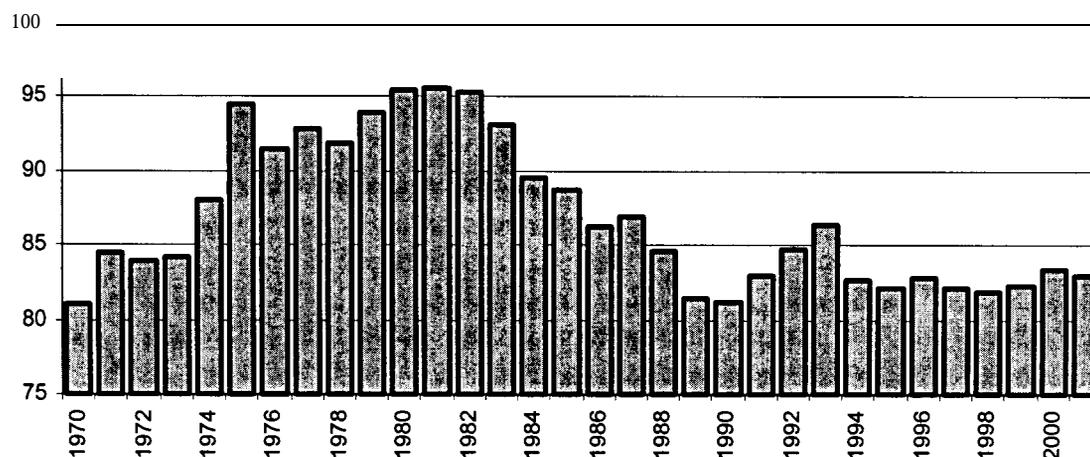
Table 1: Social security, main legal provisions

<i>Employee insurance</i>	
1930 Sickness Act (ZW)	Income loss due to sickness
1949 Unemployment Act (WW)	Income loss due to unemployment
1964 Sickness Fund Act (ZFW)	Covers medical expenses
1967 Disability Act (WAO)	Income loss due to disability
<i>National insurance</i>	
1957 General Old Age Act (AOW)	Old age pension
1959 General Widows and Orphans Act (AWW), replaced by General Survivors Act (Anw) in 1996	Pension for widows, widowers and orphans
1963 General Child Allowance Act (AKW)	Child allowance
1967 General Exceptional Medical Expenses Act (AWBZ)	Exceptional medical expenses
1976 General Disability Act (AAW)	Disability for others than employees
<i>Social provisions</i>	
1965 General Social Assistance Act (Abw), replaced in 1996 by new General Social Assistance Act	Social assistance

The oil shock of 1973 marks the end of this period. The shock leads to high energy **prices** and, through the **automatic price** compensation, to a proportional rise in wages and **benefit** levels.

The guilder remains strong because of the **revenues** from the export of gas. This worsens the competitive position, which hinders exports and depresses the exposed sector. The **economic** problems in this period have become known as the Dutch disease. So, **prices** and wages increase, and **profits** are squeezed. Unemployment starts to rise (and nearly does not decline in the period between the oil shocks) and the Keynesian expansion policy of the government now leads to rising budget deficits. The **second** oil shock (1979-1980) worsens the situation even more. The wage share in market sector income – the share of the added value that **accrues** to the factor of labour and is therefore not available for capital **costs** – increases to 95 percent (see **figure 1**). Unemployment reaches a high of about 14 percent in the beginning of the eighties. The government tries to **enforce** wage restraints by intervening with mandates on wages, but these are not **very successful** in this period.

Figure 1: wage income share market sector (in percentage of GDP)



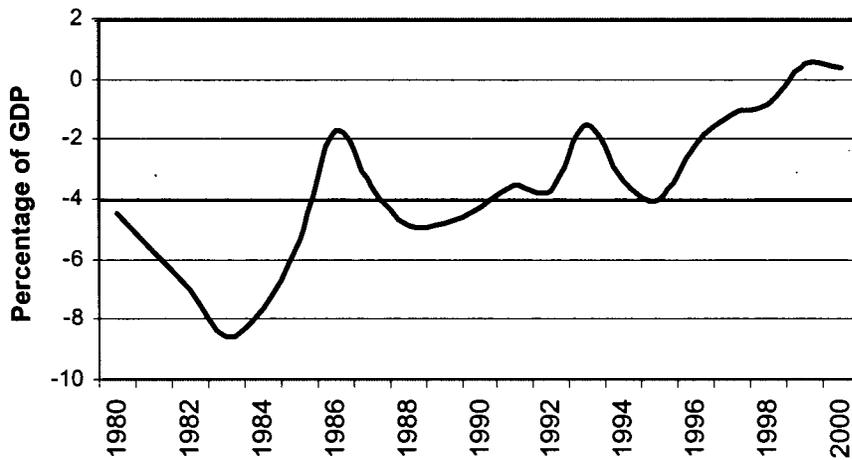
Source: CPB, *Centraal Economisch Plan 2001*.

Finally, in 1982, labour unions and employer associations **reach** agreement on a policy of voluntary wage restraint and redistribution of work in order to **restore profits** and **fight** unemployment in the so-called Wassenaar agreement. This agreement marks the start of a period of relative wage moderation (e.g. vis-à-vis **real** wages in Germany) which results in a **considerable** decrease in the labour-income ratio. In **section 4** we **discuss further** how the agreement acts as a major **first** step in the transition **from** the Dutch disease to the Dutch miracle. This switch in policy and its acceptance are more or less initiated by insights of the **economic** profession that Keynesian **demand** management is no **longer** an adequate policy **receipt** to combat stagflation. It becomes understood that the negative supply **effects** of wage **rises** are, through lower **profits** and worsening of the competitive position, stronger than the positive **demand effects**.

The start of the Lubbers Cabinet in 1982 **also** marks a switch in **fiscal** policy. The gradual expansion of the public sector (central government, local government and **social** insurance) **comes** to an end and the government budget deficit declines **from** 8.6% in 1983 to **small surpluses** in 1999 and 2000 (see **figure 2**). The **strict** budgetary policy results in a decline of the share of taxes and **social** security premiums and the share of public expenditures in GDP between 1983 and 2000, namely from 47.4 to 41.4% and 58 to 40.0%³.

³ CPB, *Centraal Economisch Plan 2001*.

Figure 2: government budget, the Netherlands

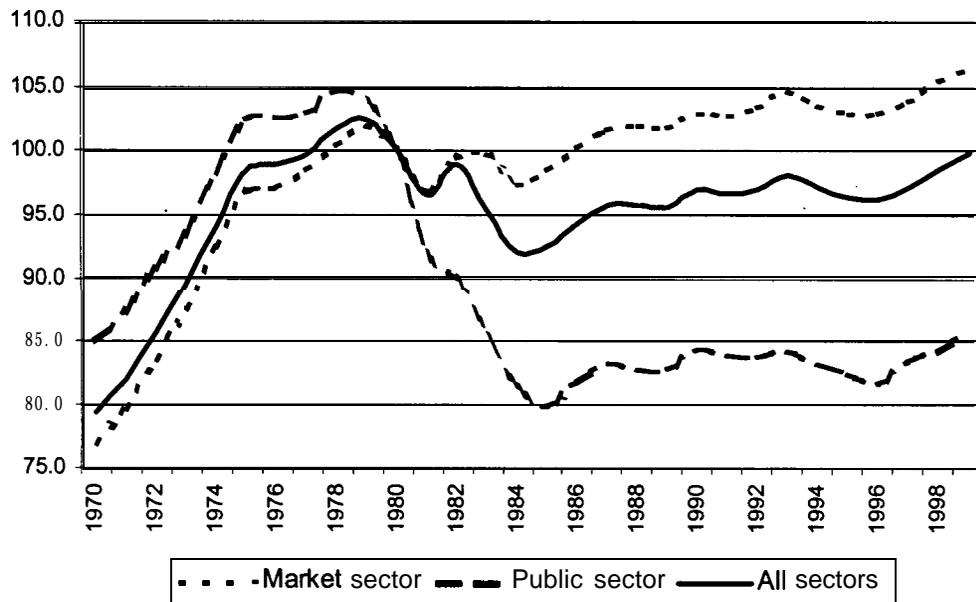


Source: CBS, *Statistical Yearbook*, SDU publishers, The Hague.

This policy of budget constraint is enforced by two developments. First, employment in the public sector decreases from 15% to 11.7% of total employment, while the wages of civil servants **stay** largely behind market developments. Putting the index for (nominal) contractual wages at 100 for base year 1980, wages in the private sector rise to 170 in 1999, while workers in the public sector see their **income** rise to 137⁴. In **real** terms, hourly wages in the public sector still are in 1999 **almost** 15 percent below their 1980 level (see figure 3). Remarkably this **happens** without serious unrest among the government personnel, although **union** density is relatively high in the public sector. The **second** source of budget improvement **comes** from reduction in expenditures on **social** security – particularly because of lower **benefit** levels and not so **much** because of a reduction in the number of **benefit** receivers.

⁴ CBS, *Statistical Yearbook*, SDU publishers, The Hague.

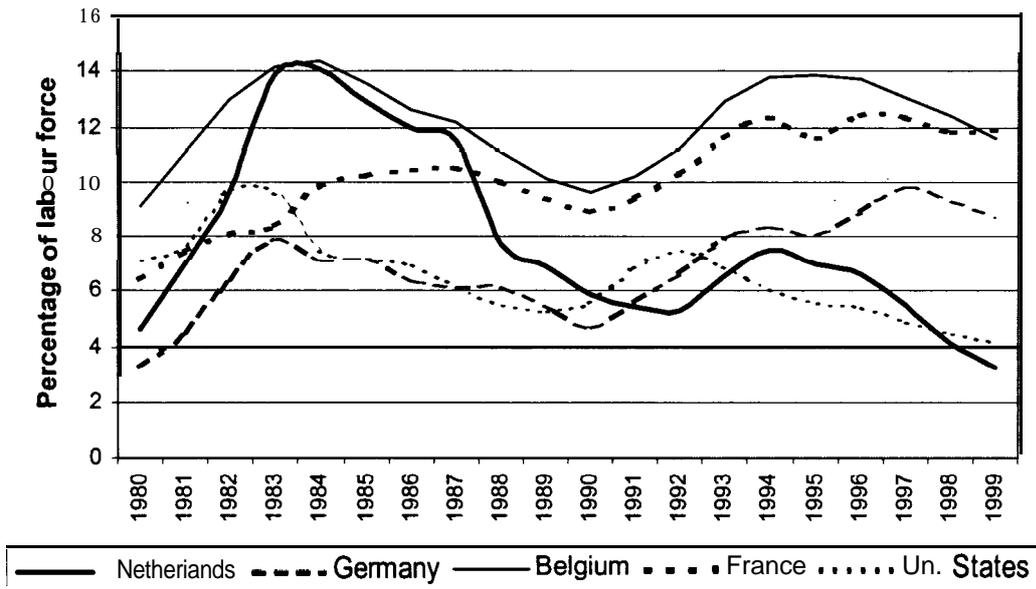
Figure 3: Real hourly wages (1980 = 100)



Source: CBS, *Statistical Yearbook*, 1970-2000, SDU Publishers, The Hague

Yet, the most noticeable change in the Dutch economy is the decline in unemployment from about 14 percent in 1983 to 2½ percent at the end of 2000 (see figure 4). Especially the fact that other European countries that used to experience the same cyclical circumstances as the Netherlands still write double digits for their unemployment performance makes this remarkable. However, official unemployment figures are not fully comparable between countries. In the Netherlands, people above 57 years old don't count as registered unemployed, because they are no longer obliged to search actively for a job since 1983. Another typical Dutch arrangement is the widespread use of early retirement, which also distracts older workers from the labour force. Above this, the Dutch disability benefit scheme attracts two to three times more people than it does in other countries: part of these receivers of a disability benefit can be regarded as unemployed in disguise, especially as the disability scheme is more generous than the unemployment scheme (Aarts, Burkhauser and De Jong (1996), Hassink (1997), Lindeboom (1992)). These three options for a comfortable early exit have resulted in a very low participation rate for elderly in the Netherlands.

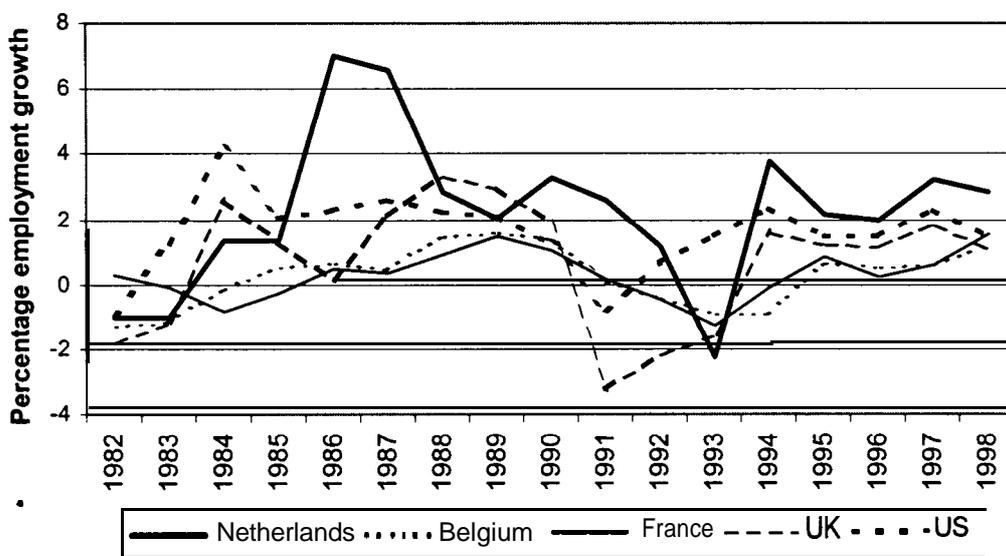
Figure 4: Unemployment (percentage of labour force)



Source: ILO Yearbook of Labour Statistics.

Although the unemployment figures look a little less **spectacular** given these considerations, the **figures** about employment are far more **conclusive**, and again underline the **economic** miracle. From 1984 on, employment growth is clearly above **European average** and comparable to the results of the American job machine (see **figure 5**). Labour participation rises from an European low of 52 percent in 1983 to 65 percent, which is about European average.

Figure 5: Annual employment growth



Source: ILO Yearbook of Labour Statistics.

3. Institutions, consultation structure and effects on trust

In the preceding section we gave an overview of the transition – from Dutch disease to Dutch miracle – that took **place** in the Dutch **economy**. In this section we focus on the **specific** Dutch institutional **framework** that, in our eyes, made this recovery possible. We **pay** attention to peculiarities of the Dutch society as the “drive for consensus” and “pillarisation”, and **how** these are reflected in the institutional setting. **After** the discussion of the various players in the field of **economic** policy **making**, we **pay** attention to some **specific** legislation on labour standards negotiations to get a better understanding of the **functioning** of the Dutch labour market. Throughout the **whole** section, a special focus is laid on the trust enhancing effects of the institutional framework. In section 4, we explain why trust is important for **economic** policy.

Consensus and pillarisation

The drive for consensus is **often** considered as a dominant social characteristic in The Netherlands. Its origin **may** even be the Dutch **historic** context of the struggle against the water. **Already** in the **twelfth** century public boards **came** into being to organise protection against the sea and initiate land-winning procedures. This common interest **forced** people to **co-operate** with **each** other and to **reach** a **compromise**, or preferably a consensual agreement, in order to be able to defend themselves against the danger of floods in **all** circumstances. Moreover, for the farming in “polders” agreement is needed on the level of the ground water and on good maintenance of the **dikes** and ditches.

This idea of consensus formation as dominant social characteristic was, in a portentous way, **combined** with another peculiarity of the Dutch society, namely its “pillarisation”. During the twentieth century until the seventies, the Dutch society was separated into four “spheres of influence”, i.e. into four separate “pillars”, namely catholic, protestant, socialist and **liberal**. These four pillars had their own schools, newspapers, broadcasting **companies**, sport clubs and political parties. For a large part, people communicated with **each** other only within **each** pillar. At the level of government, **however**, the leaders of the different pillars did not hesitate to contact **each** other and form coalition governments. These coalition governments are a necessity in The Netherlands, **where** the political parties originally represented the various pillars. It has never happened that a single party obtained a majority in parliament. This system of coalition governments **forces** the different political streams to work together, **reach** compromises and, even better, consensus.

This drive for consensus and pillarisation **constitutes** the background for the institutional framework for (**economic**) policy formation in The Netherlands. An insight in the working of these institutions is **crucial** for the understanding of **how** the trust enhancing effects of this institutional framework have contributed to the Dutch miracle.

Central Planning Bureau

A **crucial** role in this institutional set-up is played by the Dutch Central Planning Bureau (CPB) which has now renamed itself in English as The CPB Netherlands Bureau for Policy **Analysis** (CPB) as it does not want to be associated with **economic** planning in the sense of the socialist **economies**. Yet, it was founded in 1948 originally as a central planning bureau for **economic** affairs, with Tinbergen as the **first** director.

In spite of the **fact** that the CPB is formally part of the Ministry of **Economic** Affairs, it fulfils its advisory task independent **from** government interference. This status of **independence** is

recognised by **all** parties and stakeholders in the policy **making** process, which has provided the analyses of the CPB with high reputation and **esteem**. The two major periodic publications of the CPB are the Central **Economic** Plan (CEP) and the Macroeconomic Outlook (MEV). The Central **Economic** Plan is published **each** year in springtime and contains a survey and analysis of **economic** developments in the Netherlands and abroad. The CEP **also** contains **economic** forecasts for the current year. The MEV is published together with the government budget in September **each** year and contains the formal forecasts of the economy in the next year, on which the government budget has to be based. Moreover, the MEV gives revised projections for the current year.

In **fact** the CPB nowadays has two major tasks. The first is that of national auditor: this implies **economic** forecasting and assessment of the **effects** of policy measures for the government and for other groups involved in the policy **making** process. The **second** task of the CPB has remained, up to now, somewhat underexposed. It is that the CPB conducts, in the more general sense, applied **economic** research (see Don, 1996).

CPB's reputation of **independence** has been challenged **from time to time** both in **academia** and by the press, especially with respect to its task of formal auditor for the government. Here the position of the CPB is in **fact** that of a monopolist and it is true that the CPB has a special position, as it has **access** to confidential information on government policy. This position is needed in order to be able to **react** promptly on questions by policymakers, which mainly **regard** technical and accounting **aspects** in policy discussions. Yet, in the institutional framework for policy **making** in the Netherlands a number of checks and balances have been built in order to prevent the CPB to misuse its monopoly position. **Such** misuse would **also** immediately destroy **much** of the reputation that the bureau has built up so **carefully**. Besides it is a question of efficiency to have, in a relatively small country as the Netherlands, only one institute which is responsible for this kind of macroeconomic forecasting and policy evaluations. This task requires a lot of specific investments and hence the institute has to be **quite** sizeable. It is typical for the institutional set-up of Dutch policy **making** that there are **numerous** formal and informal **contacts** between the staff of the CPB and the economists at ministries, researchers in **academia** and the staff of the **social** partners. On the one hand they **provide** relevant information to the CPB, but, on the other hand, they will, if needed, be critical on the work of the CPB.

The CPB does not hold a monopoly position for its **second** task, namely that of institute of applied **economic** research. Here, it **competes** both with other Dutch institutes and with institutes abroad. Nowadays the CPB is asked more **frequently** than before to give a **second** opinion on research conduct by other institutes. Moreover, international organisations **such** as the OECD, the staff of the European Commission and the IMF publish periodical forecasts for the Dutch economy.

Since the CPB's first **director** Tinbergen (1936) has built the first **econometric** policy model it is understandable that model based policy analysis has, from the origin, constituted an important part of the work of the CPB. The CPB's 'model' early acquired a high status in **academic** circles and has **come** to be regarded in Dutch society as an **objective** piece of **economic** science (Den Butter and Morgan, 1998). The analyses of the CPB are widely used as input for **social economic** policy discussions. **However**, in the first few years of the CPB there was a **fierce** internal discussion in the CPB about the way the bureau should give shape to its advises (see Van den Bogaard, 1998). On the one **side** was Van Cleeff, **who** had the view that the CPB should follow a normative approach, while on the other **side** Tinbergen

supported the idea of disentangling the positive and normative elements of the analyses. **Crucial** in this **controversy** was in which way **economic policy advice** would be the most successful in the “pillarised” economy. Van Cleeff tried to develop an all-embracing normative theory which would integrate the ideas of the different pillars. Tinbergen wanted to develop a method that would give the most **objective** description of reality. The differences between the pillars would then be minimised to their different normative proportions. In other words, he wanted to make a **clear** distinction between the workings of the economy (model) and the policy goals (welfare functions), and then “try to agree on the first and compromise on the **second** issue”. Tinbergen won this battle. Since then, **economic** policy preparation in the Netherlands is organised in three autonomous parts: data, model and norms. The data and **statistics** are **collected** by the Central Bureau for **Statistics** (CBS), the workings of the economy are described by the models of the CPB and the balancing of different points of view is done by the government in dialogue with **unions**, employer organisations and other associations of organised interest. This method of splitting **facts** and **politics** seems to be the best in creating consensus in a pillarised society.

A major and unique example of this functioning of the CPB in policy consensus (or **rather** compromise) formation is that, in years in which general elections for parliament take **place**, the major political parties ask the CPB to **calculate** the **effects** of their **election** programs for **economic** growth, employment, **income** distribution and so on. The results for the different political parties are widely spelled **out** in newspapers and television programs. Seemingly it is **almost** a realisation of Tinbergen’s dream to separate the knowledge on the working of the economy, which is **contained** in the models used by the CPB, and the normative preferences on trade-offs between policy goals, which **will** differ for **each** political party (or pillar). In **fact** this procedure has proved beneficial in the formation of coalition governments and in **drafting** the “government agreement” that is signed by the various political parties **who co-operate** in the coalition government. In the discussions **after** the elections, **when** a new government has to be formed, those policy measures put forward by the various political parties have the best **chance** to be included in the government agreement that have, according to the calculations of the CPB, the largest favourable **effects** on the major policy goals.

However, this procedure **may** bring about some questionable **side effects**. Firstly the CPB **will** not include the various policy proposals by the political parties at face value in their model calculations, but there is ample interaction and discussion between the party officials **who write** the **economic** sections in their political programs, and the staff of the CPB **who implements** the proposals in their models. So this exercise of the CPB **may** lead to revisions of the proposals by the political parties before they are published in their **final** programs. A **second**, even more questionable **side effect** is that the economists of the political parties have become familiar with the properties of the models of the CPB and will, in their policy proposals, see to it that they are **effective** in terms of the CPB models. In **fact** a bad performance in the CPB calculations, especially with respect to employment, **can** lead to a large loss of votes in the elections. The **result** is that this procedure made the policy proposals of the political parties to be **very much** in line with proposals which are beneficial according to the models of the CPB. So it has led to a remarkable **convergence** of policy plans, which contributed to the **lack** of interest of the Dutch population for general elections – apart from “depillarisation” which **may** be another course. Moreover, there is a risk that the way the CPB models describe **economic** reality is not correct, so that **all** political parties are begging for the wrong horse in the design of their programs. This would imply an extraordinary example of a political lock-in.

Central Bank

The **second** institution which traditionally plays a major role in macroeconomic policy is the Dutch Central Bank: the Netherlands Bank (DNB). The formal task of DNB is to conduct monetary policy in order to combat inflation and to keep the value of the money stable. The Dutch Central Bank has always been **quite** independent from government intervention so that it **can** traditionally be ranked amongst the world's most independent central banks. On the other hand, the role of DNB in the policy discussions in the Netherlands is not restricted to monetary policy; DNB takes part in the most prominent forums for policy discussion in the Dutch Polder model. The **advice** and policy analysis of DNB are **well** respected and carry a large weight. Moreover, there is ample informal **co-ordination** with **fiscal** policy: the President of DNB has regular lunches with the Minister of Finance and the Treasurer **General**, who is a highly ranked **civil** servant at his ministry. The exchange **rate** policy of DNB also played an important role in **economic** recovery. The monetary policy of **fixing** the value of the Dutch guilder to that of the German Mark **can** be seen as a major contribution to the **success** of the policy of wage moderation. In this way, the relative decrease of labour **costs** in the Netherlands due to the policy of wage restraint, was not sterilised by a nominal appreciation of the guilder. As a **result** the Dutch guilder depreciated in **real** terms, which was **beneficial** to the international **competitive** position.

Foundation of Labour

It is typical for the Dutch Polder model that the **social** partners are at the heart of the consultation **structure** for **economic** and **social** policy. The "Foundation of Labour" (STAR) is the formal platform **where** employees and employers meet **each** other on a structural basis. It was founded in 1945 as a private organisation and acts as a bilateral forum of discussion for **unions** and employer associations in the field of labour standards. The seats are equally divided between the two, and both **sides** deliver one of the two chairmen. The results of the discussions are stated in "central agreements". This occurs about **once** in two or three years.

Social Economic Council

Yet the major forum for political discussions which is **associated** with the Dutch Polder model, is the **Social Economic Council** (SER). The SER is the **main** policy advisory board of the government for **social economic** matters. Its constellation is tripartite. Labour **unions**, employer associations and independent "members of the **crown**" **each** possess one third of the seats. There are three important labour **union** federations: the **socialist/catholic** FNV, the protestant CNV and the MHP for middle and **higher** ranked **personnel/managers**. Nation-wide **union** membership **rate** is about 27 percent, of which 64 percent belongs to the FNV, 19 percent to the CNV, 11 percent to the MHP and 6 percent to other **unions**⁵. There are also three employer federations at the central level. The most important is the VNO-NCW, which acts as a representative for **all** employers. Members of this federation are both individual **firms** and lower level employer organisations, **often** organised by industry. **MKB** and **LTO** are the representatives for **respective** firms of middle and small **size**, and **firms** in the agricultural sector. The "members of the **crown**" consist of professors of university faculties of economics and **law**, politicians, the president of the Dutch Central Bank and the **director** of the CPB.

It is through these independent members that the policy discussions within the SER **benefit** from the insights of **scientific** research. The analyses of the CPB and DNB carry a large weight in these discussions. Policy advice by the SER are prepared in **committees** where representatives of the three **categories** discuss and amend texts drafted by the Secretariat of

⁵ These CBS data **relate** to **January** 2001.

the SER. Representatives of various ministries attend these meetings of the **committees** but formally they are observers. They **will** not take part in discussions unless they are asked to **provide** relevant information. Obviously it is important for the impact of the advises of the SER that they are unanimous. It is **quite** exceptional that the government would disregard a unanimous policy **advice** of the SER. The independent members of the **crown** (which, by the way, represent the various pillars in the Dutch society) **can**, in informal discussions, be helpful in reaching **such** a consensus **advice**. A major role in this situation is played by the chairman of the SER, **who** is **also** an independent member, and understandably has a **crucial** position in the institutional set-up of the Dutch Polder model.

The SER has an important function in promoting trust between the various policy makers by **acting** as a platform of discussion for social partners, government, central bank, CPB and scientists. The positive role of the SER has, **however**, not always been recognised by the government. The **legal** provision that the government was obliged to ask the SER for **advice** on all proposals for **social-economic** legislation was abolished in 1995. The feeling had arisen at the government level that this procedure took too **much time** and **caused** too **much** “stickiness” in the policy preparation procedures. **However**, instead of weakening the position of the SER in the **process** of policy preparation, this measure seems to have strengthened it. The measure worked, probably unintended by the government, as a trigger **mechanism** for the members of the SER to **reach** consensus in its policy recommendations. Recommendations that are signed unanimously by the three parties involved give a strong signal to the government of societal consensus on specific policy measures, and are therefore **much** more powerful than recommendations that reflect divided opinions. As mentioned above, the Dutch culture of consensus puts strong pressure on the government to follow unanimous recommendations. The government is, **however**, not bound to act in the way the SER recommends, although it is obliged to give a formal reaction statement at **every** published **advice**.

The SER thus **fulfils** two **main** purposes. First, it works as a **device** for the government to get informed about the points of view of employee and employer organisations about **social-economic** questions. Especially the unanimous recommendations give the government **clues** about what policy measures **will** be supported by society. **Second**, the SER works as a platform that brings together employee and employer organisations to talk with **each** other about **social-economic** matters. The presence of **economic** and **legal** scientists **makes** sure that the discussions are based on solid arguments. In this way they learn about **each** motives and **objectives** for and against certain policy measures. This prevents misunderstandings and **can** form a basis for developing mutual trust.

One of the major **aspects** in the negotiations in the SER, which is related to the idea of trust, is that the **main** negotiators meet **each** other regularly both in formal and in informal meetings. So it is the repeated game aspect of trust formation which plays an important role here. An example of this attitude **can** be found in an interview by **Arjo Klammer** (1990) on the occasion of the 40th anniversary of the SER. **Klammer** posed the following question to Jan Stekelenburg, at that **time** the chairman of FNV, the largest trade **union**. ‘My impression is that you and Van Lede – chairman of the largest employers organisation – are **very much** on speaking terms and that you are more friendly to **each** other than the outside world believes you are.’ Stekelenburg’s answer is: ‘No, no, that is not true! It is certainly not true that we’re constantly fighting with **each** other, but at the moment of conflict it is **clear** and apparent and we don’t ease the problem **when** we are together.’ Then **Klammer** asked: ‘Did it happen that you were really angry with Van Lede?’ Stekelenburg **replied**: ‘Yes, **when** there is really a large conflict

I **may** be angry. **However**, it **will** happen in a way which does not harm our future relationship, because we are condemned to **each** other. We need **each** other in these negotiations on labour relations, so that we should be aware that **after** a big quarrel we **will** always be **forced** to **come** back to business in a next situation. So the **real** hard and definite battle **will** never be fought.'

Committees

A **further** major role in this **technocratic** process of **economic** policy preparation is played, albeit somewhat outside the spotlights of attention, by committees inside the ranks and files of the government. The "Council for **Economic** Affairs" (REA) and the "Central **Economic** Committee" (CEC), are especially influential in this respect. The CEC consists of highly ranked **civil** servants from the key ministries involved in **economic** and **social** policy. The **committee** is chaired by the secretary general of the Ministry of **Economic** Affairs and it is through discussions in this **committee** that calculations by the CPB have inspired to major **changes** in **economic** policy (see Den Butter, 1991). Incidentally, **when** no consensus **can** be reached about **difficult** policy problems in the institutional framework **sketched** above, special committees are established for policy **advice** on these problems. A recent example (2001) is the **committee** chaired by Donner, former chairman of the Scientific Council for Government Policy and member of the "State Council", which is asked to **provide** a new design for the **social** security arrangements for disabled workers (WAO).

Scientific Council

A danger that threatens the close consultation **structure** as it exists in the Netherlands is that it is **susceptible** to **inertia**, and even to lock-ins so that **radical changes will** never be initiated. In order to get **out** of **such** a situation, it sometimes helps if an outsider rings the alarm bell. This has become one of the functions of the Scientific Council for Government Policy (WRR). The WRR was founded in 1972 to **provide advice** to the government about long-term **policies**. Though this multidisciplinary **Scientific** Council is not a really a part of the consultation **structure** of the Dutch labour market, its reports are among the most influential **social-economic** analyses.

Parliament

After all consultations in the institutions in the Polder model have been conducted, it is, of course, in the **democratic state** of the Netherlands in the end always the parliament that **decides** about policy measures proposed by the government. Yet the outcome of the consultations **will** always carry a large weight in the voting behaviour of the members of parliament.

Wage negotiations

It is not only in the **structure** of organised meetings in the STAR and SER and other platforms that trust between policy maker is improved. **Also** the general **structure** and **legal** environment of the wage negotiations give incentives to the different parties to **co-operate** and **reach** consensus. We **first** take a look at these features of the wage negotiations at the central level, **after** that we continue with negotiations at industry and **firm** level.

At the central level, two **times** a year a **fixed** consultation process between government and **social** partners takes **place**. These are called the "spring"- and "autumn"-consultation. These are again two moments **when** official meetings between government and **social** partners take **place**, but the process **also** favours trust within the organisations, as **will** be clarified below. Starting-point for the spring-consultation is the new plan for the government budget, the

autumn-consultation marks the beginning of a new round of wage negotiations. The preparations for the yearly **cycles** of wage negotiations start in the two largest federations of **unions** (also see Teulings and Hartog, 1998: 281). The biggest employee federation, the FNV, uses the macro-economic forecasts of the CPB to **calculate** the “wage bargaining space”. This concept describes the reasonable wage **cost** increase and is usually calculated as the sum of inflation and change in labour productivity. Note that it is not defined in what **definitive** form this wage space should be realised (wage increase, labour **time** reduction, **schooling**, **fringe benefits**). Together with other **wishes**, this is **written** down in a document and then discussed with the chairmen of **all** member **unions**. The other big federation (CNV) follows a procedure that is **quite** similar. Apart **from** this consensus and consultation approach, the central strike fund serves as a way to **promote** **unity** in **union** federations. Only **unions** that strike in line with federation bargaining positions **can receive** support **from** this central strike fund. These are two ways to keep member **unions** and the federation at the same line of **policies**.

Employer organisations **also co-ordinate** their bargaining positions for the new wage negotiations. The Committee for the Preparation of Wage **Policies** prepares the fundamental **principles** for the negotiations in **each** year. A general strike **fund** is open for members that are hit by **strikes** that deal about **fundamental** issues discussed by the Committee.

Incentives for **co-operation** are **also** present in negotiations at the industry and **firm** level. To make this **clear**, we **first** have to take a somewhat **closer** look at the regulation of **collective** labour agreements. Two laws regulate the completion of **collective** labour agreements. First, the **Law** on the **Collective** Agreement of 1927 stipulates that the terms of a **collective** agreement are binding for **all** workers in the **firm**, not just members of the **union** signing the agreement. **Second**, the **Law** on Mandatory Extension of 1937 gives the right to the Minister of **Social** Affairs to extend a **collective** agreement to the entire industry. To get extension, one of the bargaining parties must send a request to the Minister, **who** checks some formal criteria. The most important is that the **collective** agreement must cover a substantial majority of the industry. The maximum duration of an extension is two years.

There are several features in the system of wage bargaining that give incentives to **all unions** to sign an agreement and to the employers to sign an **agreement** with **all unions** (also see Visser and Hemerijck, 1997). By **making** it favourable for **all** parties to **reach** an agreement, these incentives stimulate the formation of consensus and trust. Because an agreement **can** only be reached **when** standpoints **come** together, this incentive **structure** **also** favours the moderation of demands and **wishes** of the parties and thereby promotes “reasonable” outcomes.

An important incentive **comes from** the **fact** that employers are **free** to start negotiations with **any union**, but are not obliged to do so. Firms are not legally bound to acknowledge **any union**. The **law** of 1927 states **further** that **when** the employer signs an agreement with **any union**, this agreement functions as the agreement for **all** employees, regardless of their eventual membership of this or another **union**. So, at **any** moment, anyone **can** start a **union** of his own and **every union** **can** try to get in negotiation with the employer. **Unions** are allowed by court to strike to **reach** this purpose. This **means** that **unions** always run the risk of being excluded **from** labour negotiations by the employer. This sometimes even occurs to the most important **unions**, so it is a credible threat. The **main** reasons why **unions** want to be involved in the negotiations are threefold. The **first** reason is of course that they want to **reach** something for their members. They have no reason of **existence** if they’re not the sparring partner of the employer. The **second** reason is that only the **unions** that have signed the

agreement are entitled to the rights that **come forth out** of the agreement. The third reason is that the **unions** that have signed the agreement **receive** a **fixed** amount of money per worker in the **firm/industry**, to be divided between the different **unions** in proportion to their **respective** amount of members. The combination of these three reasons with the possibility of exclusion gives **unions** incentives to form coalitions with other **unions** and mitigate their claims. They are **very well** aware that the party with the most extreme claims bears the highest risk to be excluded.

The employers **also** face an incentive to include as **many** as possible **unions** in the negotiations. **Collective** labour agreements usually contain a **clause** that forbids the **unions** to organise or support **strikes** during the **time** period the agreement is valid. Since, of course, only the **unions** that signed the agreement have to **obey** this **clause**, the employers have an incentive to get the agreement signed by as **many unions** as possible.

Trust evaluation

Looking at the Dutch institutional **framework** for **social-economic** policy preparation, we **notice** that it has several characteristics that favour the formation of trust and **co-operation**. To begin with, there seems to be a character trait or culture prevalent in the Netherlands that is favourable to **co-operation** and consensus, possibly descending from a joint **fight** against the water. With other words, there seems to be a sort of “**basic trust**” **upon** which actual mutual trust **can** be developed. This **can also** be related to the idea of the path-dependency of trust (see for example **Putnam**, 1993). Given the **fact** that most people in a society **feel** inclined to act in trustworthy ways, it is **beneficial** for **all** people to keep to this way of transacting, because it **will** raise extra **benefits** for the involved parties by being able to solve **co-ordination** type of games. **However, when** most people in a society are used to act in uncooperative ways, **every** individual must **distrust** other people in order not to be exploited. In this way, the level of trust at a given date in a society has its **effects** for trust in the future. The inherent **co-operative** stance of the Dutch thus favours the formation of trust.

A **second** characteristic is that people are aware of an external threat and their own vulnerability. This external threat used to be the water but nowadays seems to be replaced by foreign competition. The inhabitants of small open **economies** have to **find** ways to deal with this without the option of **protectionism**. This demands **co-operation** of **all** interests in society.

This is reflected in the way policy preparation is organised. The **structure can** be regarded as corporatist, in which government and organised interest together search for solutions. “[O]rganised interest does not have to lobby, they are **welcome** partners in the conference room” (Hartog, 1999: 8). The third characteristic is thus formed by the **framework** of institutionalised **contacts** between government, **social** partners, central bank, CBS, CPB and advisory boards. The representatives of **all** these groups meet **each other frequently**, both in formal (meetings of the SER, STAR, spring- and autumn-consultation, CEC, REA) and informal occasions (receptions, farewell parties, etc.). These frequent **contacts** culminate into better information exchange and thereby prevent misunderstandings. But this network with a relatively low number of players and a high meeting frequency is **also** very favourable for the formation of trust. The Dutch institutional **framework** seems to fit **almost** completely with **micro findings** on how to build trust-enhancing networks. The group of players is relatively small. As we have seen **from** the interview by **Klamer** (1990) there is a lot of repeated **contacts** between the players. A substantial part of it is face-to-face and informal (see e.g. **Ostrom** and **Walker** (1997) for an analysis of public good games in which face-to-face communication leads to substantial increases in **co-operation**). Every player belongs to an

organisation, so reputations **can** be smoothly transferred **from** one representative of the organisation to the other. With other words, a reputation of trustworthiness does not disappear (completely) **when** individual **persons** are replaced. Reputations are important, because **policy-making** is a **dynamic process**. Organisations meet **each** other over and over again, and know that this **will** not change in the coming years. Together with the aspect of the small group, this leads to the **fact** that the possibilities for learning and **control** are substantial.

For the situation in which repeated interactions between agents take place, Buskens (1999) distinguishes two types of **effects** on the behaviour of the trusting party. These are learning and **control**. "Learning **indicates** the extent to which a trustor **can** modify her expectations about characteristics of a trustee **from** observing his behaviour in past transactions. **Control indicates** the extent to which the trustor **can** influence the trustee's behaviour via sanctions anticipated by the trustee" (Buskens, 1999: 11). Learning and **control** become more powerful, **when** repeated transactions are not only taking place on a bilateral basis, but are **also** observed by other agents **who** act as (potential) transaction partners. **Social** networks and reputation become important in this situation. In the Dutch **framework** with small groups and high **frequency** of **contacts**, we see that people learn quickly about the behaviour of others. Reputations spread fast. **When** some party acts against the norms, it **can** be punished quickly both within the group (news travels fast in small groups with frequent **contacts**) and in public (with help of the press). In this way, a good reputation becomes valuable for organisations. **Once** obtained a reputation of trustworthiness, they **will** be eager to keep it, for it enables them to **participate** in mutually **beneficial** transactions.

The fourth characteristic is the **specific** legislation on **collective** labour agreements that promotes **co-operation** between **firms** and **unions** at the level of industry and single **firm**.

As a last characteristic we **can** see the tendency to decentralisation. Since 1982, the government has withdrawn itself **from** direct intervention in wage negotiations, thereby giving the **first** responsibility for a sound wage development in hands of **social** partners. This forms a trigger **mechanism** for **social** partners to **co-operate**. Both **union** and employer federations want the government to **stay out** of "their realm". They know, **however**, that the government has the power to intervene **when** they do not succeed in negotiating reasonable labour standards. This forms again an incentive for **co-operation**. Above this, **every time co-operation** succeeds, trust grows between the parties, which **makes co-operation** even more likely in the future.

4. Labour market theories and trust

In the previous **section**, it was shown **how** the **specific** Dutch institutional **framework** promotes **co-operation** and trust between the **economic** policy makers. This **section** connects some theories of the labour market, like **specific** investment, the hold-up problem, **union** behaviour and search theory, with the concept of trust, thus showing the **importance** of trust in theoretical considerations. **After** this, we consider the appropriateness of the theoretical model for the Dutch situation. In the following **section** this model and its consequences are related to the policy measures that are held responsible for the Dutch miracle.

Hold-up problem

The hold-up problem **can** be seen as a **result** of a combination of bounded rationality, scarcity of information and uncertainty. These three make it impossible to **write** down complete and

legally binding contracts, which opens the way for opportunism: people **can** gain short-term **benefits** by cheating. The combination of opportunism and **specific** investments **can** lead to hold-up problems (Williamson, 1985). Specificity of an investment **means** that the value of an investment is directly dependent **from** the continuation of the relationship. An example of a specific investment is a **firm** investing in the skills of an employee while these skills are only valuable in this specific **firm**. The effect of this investment is that the labour productivity of the employee in this **firm** is raised. As long as the employee stays within the **firm**, the investment leads to extra rents (to be divided between **firm** and employee). **When** the employee leaves the **firm**, these gains are lost. This gives additional bargaining power to the employee, because he **can** threaten to leave the **firm**. The **lack** of complete contracts hinders in this case mutually advantageous trade. Though there are profitable investments to be made, potential investors **refrain from** doing so, because they are **afraid** that their transaction partner will hold them up.

A solution for this problem is to **allocate** ex-post (**after** the investment has been done) bargaining power to the party that **carries out** the investment. The obvious way to do this is by internalising the transaction. Labour, **however**, cannot be internalised (that **would mean** slavery). The **second** best solution seems to be the agreement on a long-term contract. The wage in **such** a contract should be between the outside options for **firm** and employee. The outside option for the worker is his fallback position outside the **firm**. It is the wage that other **firms** would want to **pay** for his services. Since the specific investment raised the productivity of the worker only in this specific **firm**, this outside wage is **usually** lower than his inside wage. This outside wage (or marginal productivity of the worker before the investment) forms the lower boundary of the inside wage. The outside option of the **firm** is equal to the **cost** to hire a new employee and to train him until he has the same productivity level as the incumbent employee. The **cost** of a new employee (the marginal productivity **after** the investment) forms the **upper** boundary of the wage. As long as the wage is between these outside options, it is **efficient** for both parties to continue the relationship. This situation is called "mutual hold-up" (Hashimoto, 1981). Both parties are not credible in their threats to leave the relationship **when** the wage is in this corridor between the outside options. It is **efficient** for both of them to continue the relationship.

A solution for the hold-up problem could be that parties **write** nominal contracts on the distribution of the returns a priori, or with other words, parties **fix** in a contract the nominal wage level in the corridor between the outside options (**also see MacLeod and Malcomson, 1993**). To prevent the appearance of hold-up problems, it is stipulated that there **will** be in **first instance** no renegotiations about the wage level. There **will** be only renegotiations, when one of the outside options becomes binding. In this way, **inefficient** separations **can** be prevented while the hold-up problem is suppressed.

A problem with this model is that it **relies** on the assumption that both parties know **each respective** outside options. Although the model is restricted by this unrealistic assumption, there is some **evidence** that the model describes reality to some extent. Beaudry and DiNardo (1991) show that the lowest unemployment **rate** since the start of a job has a strongly significant upward effect on the current wage, which is considerably larger than the **effects** of the current employment **rate**, and the unemployment **rate** at the start of a job. The lowest unemployment **rate can** be considered to be the period with the most valuable outside options for the workers, which, according to the model, should **result** in upward adjustment of the wage to prevent incumbent workers from leaving the **firm**.

The problems involved with the “shaky” assumption that both parties know **each** outside options grow, **when** the economy is hit by unexpected aggregate shocks. It could be assumed that parties know **how** to handle with idiosyncratic shocks, but it seems less likely that this is **also** the case for aggregate shocks. Two unfavourable situations **can** occur. First, there **will** be renegotiations of the contract and the employer is held-up. **Second**, the employer refuses to renegotiate in fear of being held-up and **inefficient** separation takes place. Both possible situations lead to a lower than **efficient** investment level. The **micro** level thus seems not to be the right place to adjust nominal contracts to aggregate shocks.

A solution for this problem is to delegate the task of adjusting contracts to aggregate shocks to corporatist organisations. By delegating the wage negotiations to a **higher** level, the link between bargaining power as a **result** of **specific** investments and the level of **specific** investments is **broken**. Negotiators at the **higher** level are less prone to opportunism. They bargain over wage **changes** for **whole** industries, while the **specific** investments vary per **firm** and employee. Above that, **unions** don't want to put their relationship with the employer associations at stake. Furthermore, we **can** say that “[a]ctive corporatist intervention is superior to mechanical adjustment **rules**, as these **rules can** never **anticipate all contingencies**. **Rules** require shocks to be contractible, while for corporatist institutions shocks need only be observable” (Teulings and Hartog, 1998). It is too costly to **arrange** a contract that includes **all** eventualities and their remedies, ex ante, but it is always possible to adjust the contract **after** some particular shock occurred.

Two types of labour unions

This way of contract adjustment by delegation to organisations at a **higher level** involves that both **unions** and employer organisations are trying to **maximise** the joint surplus of both **sides**. In the standard neo-classical models of **union** behaviour, **unions** only try to **maximise** the utility of their members. This **may** describe the situation in decentralised **economies** very well, but certainly not in **economies** with a corporatist design (**also** see Teulings and Hartog, 1998). In decentralised **economies** in which no bargaining at a central level takes place, **unions** have an incentive to **operate** in antagonistic ways. They strive to get the highest possible wages for their members. On the short term, this **fulfils** best the **wishes** of their members. Membership of a **union** is thus interesting for workers. These kind of **unions** have an incentive to raise their membership level in **firms** in which they are **already active**, since this increases their bargaining power. Threats of **strikes** or other obstructions of the work **process** become more credible with **higher rates** of membership. **Firms will react** in hostile ways to this **union** behaviour and do everything to prevent **unions from** getting a solid base in their enterprise. This leads to a scattered presence of **unions** among **firms**. In some **firms**, they are **very powerful** and this **makes** it **attractive** for employees to become and **stay** member, in other **firms**, they have hardly **any** members and the management of these **firms** prevents them from growing.

In more corporatist societies with centralised wage bargaining, the strategy of **unions** is different. They have an incentive to **maximise** the joint surplus by bargaining in ways as to prevent hold-up problems. Because these negotiations lead to **higher** efficiency of the economy, employers carry a benevolent attitude towards these **co-operative unions**. The labour **unions can demand** a **portion** of the extra rents that **result from** the increased efficiency in the form of **higher** wages. **Economies** that are characterised by **co-operative unions**, show a **diffusion** of **union** members over **all** industries, but with low **average** union density. Free-rider problems are involved with this. To prevent hold-up problems, the results of the negotiations

apply to all employees, so that **union** membership does not offer the “carrot” of a **higher** wage.

A second source of different incentives for these two types of **unions** comes from the problem of insider power. Co-operative **unions** feel the pressure of their members to **first promise** the employers a co-operative strategy, but, **after** specific investments have been made, to use their increased bargaining power to **demand** a larger **fraction** of the extra rents, which would **mean** a switch to antagonistic **practices**. This “insider power” **can** be kept under **control**, **when** membership is spread over different industries as is usually the case in corporatist societies. Different members are then **confronted** with different idiosyncratic shocks, which leads to a minority of members that **wishes** wage increases, being ruled **out** by a majority of members that wants to save their reputation and keep on with maximising joint surpluses. This **makes** **unions** in corporatist societies credible (and **unions** in decentralised countries incredible) in their co-operative stance.

Trust involved

The **mechanism** by which hold-up problems are prevented in corporatist **economies** requires a substantial amount of trust between the bargaining parties. Both parties, employer and employee organisations, **can feel** the incentive to **cheat**. This problem **can** be seen as a prisoners’ dilemma problem. The **social** optimum would be to **co-operate**, but there are **short-term** incentives to defect. Why would parties trust **each** other? A **first** reason **can** be found in the value of a reputation of trustworthiness for a party. **Having** **such** a reputation **creates** value, because it stimulates other parties to **engage** in mutual beneficial trust-related transactions. The **higher** the frequency of these transactions and the easier it is to recognise the trustworthiness of the players, the more valuable the reputation becomes. Players **will** thus be **very careful** not to waste their reputation.

A second reason for mutual trust **comes from** social norms. These **can** help to solve these co-ordination problems by providing a focal point in the (re)negotiations about future wages (**also** see Teulings and Hartog, 1998). The norms ensure that the beliefs about the **out-of-equilibrium** behaviour of others are in **place**, and the others **will** stick to the **implicit** contract during the renegotiations **process**. Social norms **also** have an important **function** in **making** the individual **firms** and workers accept the centrally bargained agreement as being a focal point. The individual members must trust their representatives at the central negotiations to have bargained the best possible agreement for them. The representatives must trust that the individual members **will** support their bargained outcome. Without this mutual trust, the system does not work. There is no sense in bargaining at a central level if the individual employees and employers are not willing to accept the **results**⁶.

A **specific** norm that could offer **such** a focal point is fairness. The literature on microeconomic experiments shows that unfair behaviour is usually reciprocated by severe punishments, even **when** this **creates** some **costs** for the punishers themselves (see for example Giith, Schmittberger and Schwarze (1982) and Camerer and Thaler (1995) for **findings** of negative reciprocity in ultimatum games, and **Ostrom** (2000) for a short overview of findings in public good experiments). The bargained labour conditions **will** therefore have to be considered fair. The source of the norms of fairness differs between decentralised and

⁶ In the case of the Dutch **metal** sector, Poortvlied and **Akkerman** (2000) conclude that most of the central recommendations of the STAR appear at the agenda of **CLA-negotiations** at the **industry** and firm level. Members of the STAR have in general a positive judgement about **how** their recommendations have worked through into the results of the **CLA-negotiations**.

corporatist economies. In decentralised economies, the focus is entirely put on what **happens** at the level of the **firm**, since information about shocks that occur at the aggregate level is not or insufficiently known. So, the focal point **will also** be perceived at the level of the **firm** and rent sharing at this level becomes the norm. In corporatist societies, the focal point is at the macro level **where** corporatist organisations bargain over their “central agreements”. With this focal point of fairness, it is **very difficult** for **firms** to deviate and set their own standards without facing the risk of retaliation.

The findings of **Gordon** (1994) **can** be related to this. He shows some **evidence** that antagonistic labour relations **can** be associated with decentralised economies, and **co-operative** relations with corporatist societies. In decentralised economies, the supervision intensity is substantially **higher** than in corporatist economies. The bargaining power of individual employees is in the former probably put in check by supervision measures, whereas in corporatist societies **social** norms and the delegation of power to **higher** levels **fulfil** this task.

Appropriateness of the hold-up model

Can the Dutch institutional context be linked to the hold-up model? The way in which wages are yearly adjusted gives some **evidence**. The **structure** of the yearly wage increases in the Netherlands **fits very** neatly in the **MacLeod** and **Malcomson** contract model (**also** see **Teulings** and **Hartog**, 1998: 271). A **first** corresponding aspect is that the **contracts** are **written** in nominal terms.

The **second** resemblance is the decomposition of the wage increases in three parts. The **first** part concerns the contractual experience and **tenure profile**. Usually, **every** employee gets a yearly wage rise, because **every** additional year of **tenure** **rises** him one step at some specified fixed-wage **scale**. This part of the wage increase **can** be seen as the **contracted** wage increase in period 1 for period 2 **when** no shocks occur. The **second** component of the wage increase is negotiated by the corporatist organisations and consists of a **fixed** percentage increase for **all** wage **scales**. This is called the contractual initial increase, and **can** be seen in the model as an adjustment to aggregate shocks that **can** be better handled by corporatist organisations than by negotiations on the **firm** level. The last part of the wage increase are the incidental increases, which is the set of increases not explained by **components** one and two. These **changes** are negotiated at the **micro** level. **Notice** that this component is zero for two thirds of **all** workers, which is in line with the implications of the hold-up model.

Also corresponding with the hold-up model is the freedom of employers to set wages for new hires. Wages for new hires are **almost** never set at the lowest possible wage **scales specified** by **collective** labour agreements, but based on the **subjective** interpretation of the capacities of the new hire by the employer. **When** the new employee is settled in a specific wage **scale**, he follows the yearly increases as is **contracted** by the corporatist organisations on the industry level. In terms of the model, the **micro** level is best suited to value someone's particular capacities, a **higher** level is best suited to determine the appropriate wage increases as reaction on aggregate shocks.

Other **aspects** of the model that are similar to the Dutch **practice** are the long-term **collective** labour agreements and extensions which are **very** common in the Netherlands. They form an institutional **structure** in which employer and employee organisations **can** make long-term agreements on the development of wage **costs**. In the discussion of specific investments, we have seen that it facilitates mutually advantageous trade, if ex-post bargaining power is allocated to the party that **carries out** important non-contractible investments. Applying this to

the literature of search models, in which specific investments occur in the creation of **vacancies** and searching for jobs, the Hosios **condition** tells us **when** the search intensity of workers and welfare of society are maximised (Hosios, 1990; Boone and Bovenberg, 2000). This process **hinges** on the relative bargaining power of workers and employers, which results in the relative distribution of the rents. Too low bargaining power for workers implies low search activity because of low wages, while too high bargaining power discourages employees **from** looking for a job because the probability of **finding** one diminishes **when** wages rise. Stating the division of rent in long-term contracts prevents the employers and employees **from** enlarging their bargaining power. **Such** a change in bargaining power would **mean** that the ex-post level of bargaining power would differ **from** the ex-ante optimal level of bargaining power with as a **consequence** that the optimal distribution of rents would be disturbed.

We **may** conclude that the model of **MacLeod** and Malcomson that describes long-term contracts as solutions for hold-up problems is relevant for the Dutch situation. We saw above that delegation of wage bargaining to corporatist organisations even **further** mitigates hold-up problems **when** **social** partners act trustworthy in the bargaining process. Since we have seen, in the previous **section**, that the Dutch institutional framework consists of several trust enhancing features, it seems appropriate to link these observations with the actual policy measures that are held responsible for the **economic** recovery. This is done in the next **section**.

5. Trust and the Dutch practice

This **section** pays attention to the three policy measures that are considered to be mainly responsible for the Dutch miracle. They **will** be analysed in relation to the model of **section** 4 and the **importance** of trust between the **main** players. Before this, we focus on the Wassenaar agreement, which is seen as the starting point for these new **policies**.

Wassenaar Agreement

The most **famous** agreement that is **produced** by the STAR is the central agreement of Wassenaar in 1982. This agreement, in which wage moderation is **coupled** to labour time reduction, is seen as a turning point **from** the Dutch disease to the Dutch miracle. It marks the moment that **unions** and employer associations started realising that they had to **co-operate** in order to find a way **out** of the **economic** crisis. Although the Wassenaar agreement was maybe nothing more than a **beacon** of change – its text is **rather** short and vague – **after** it mutual trust developed quickly and the agreement was followed by a string of other central agreements. It marked the beginning of an “ideological **pacification**” between **social** partners (**also** see Van Bottenburg, 1995: 199).

How did the agreement **come** into being? As we saw before, the **economic** situation in the beginning of the 1980s was unsustainable. The **unions** were not in a favourable position. They were losing members in a fast way and the government was threatening to use wage measures to get rid of the **automatic price** compensation rule (Van Bottenburg, 1995: 194). Especially the **threat** of the government to intervene seems to have **functioned** as a trigger **mechanism** for **social** partners to **reach** an agreement. The **unions** reasoned that they would gain nothing if the government intervened, but that they could **expect** something in exchange if they would **reach** an agreement with the employers. The compensation the **unions** sought (and got in the end) was a redistribution of work. This redistribution, given shape as labour **time** reduction, was meant to **fight** unemployment.

It is noticeable that not only the **unions** had an incentive to prevent government intervention in the wage development. **Also** the employer associations wanted to leave the government **out** of the realm of labour market negotiations, although they had a different motive. The employers were wary about the level of ambition the government would attain to lower unemployment. They feared that the government would copy policy measures implemented in **France** and **Belgium**, **where** governments announced collective job plans and obligatory working **time** reduction (**also** see Visser and Hemerijck, 1997).

Notice, however, that the central agreements, signed by the chairmen of the employer and employee federations, are not binding for member **unions** and associations, nor for individual members. They just **function** as a focal point for negotiations at lower levels about labour standards. This is reflected in the **names** given to the central agreements. They vary from "central recommendations" (1982), to "common policy framework" (1989), "social-economic policy orientations" (1992) and "agenda for the discussion on collective labour agreements" (1992).

Although these central agreements of the STAR only put moral pressure on negotiating parties at industry or **firm** level, this moral pressure has proved to be strong enough to change the outcomes of labour negotiations to a large extent. The agreement of Wassenaar of 1982 is illustrative. The Wassenaar agreement stated the **importance** of restoring **firm** profitability through wage moderation. Together with labour **time** reduction, this should **encourage** investments in employment. The agreement was **very** short, **written** in vague terms and not legally binding. The results, **however**, were impressive. In reaction to the Wassenaar agreement, the government enacted a **law** that made it possible to open up **all** existing collective labour agreements and to postpone the **automatic price** compensation. In one year, about two thirds of **all** collective labour agreements had been renegotiated. On **average**, the **price** compensation was postponed for two years and the **average** working **time** declined with **five** percent. Between 1983 and 1985, the **average** wage decreased in **real** terms by nine percent (Visser and Hemerijck, 1997). The labour **income** ratio decreased **from** 95.3 percent in 1982 to 81.5 percent in 1989.

An additional stimulus for the instrument of wage moderation **came from** the CPB. More or less as a coincidence, the CPB based its **economic** policy analyses at the end of 1970s on a vintage model in which the favourable **effects** of wage moderation on employment were **much** stronger than the negative **income effects** (Den Butter, 1991). According to the model, lower labour **costs** would have a strong positive effect on the **economy**, because it increased the return on capital and would therefore postpone the replacement of machinery by more **labour-extensive ones**. So in accordance to the model, the CPB **already** had "instructed" **social** partners and government for some years, that wage moderation would be the most appropriate measure to revive the **economy**. It marked the end of Keynesian **demand** policy.

A third important **result** of the agreement of Wassenaar, besides the stimulus to **further** co-operation between **social** partners and the start of a policy of wage moderation and work redistribution, was the retreat of government from the realm of labour market negotiations. This implied a **drastic** break with the past. Before 1982, the government intervened **often** and in a direct manner. In the nine years before the Wassenaar agreement, the government intervened directly with wage measures in **six** **respective** years. In the period **after** 1982, the government abstained **from** interference. It always followed the developments in labour standards closely, but used the possibility of wage measures only as a trigger **mechanism** to

make sure that social partners would by themselves **reach** reasonable negotiation **results**⁷. Although the government does not intervene anymore in a direct way in the field of labour standards, it still influences and supports developments that it considers favourable for the economy. For example, the government supported the policy of wage moderation that social partners had agreed on, by lowering taxes and premiums for social security. In this way, the decline in purchase power of families was **softened** and thus made the agreement more **acceptable** for workers. Another example is that **when** social partners agreed on redistribution of work and ongoing liberalisation of the labour market, the government responded with a **law** on flexibility in labour relations, thereby adapting the **law** to the changing preferences for flexible working hours.

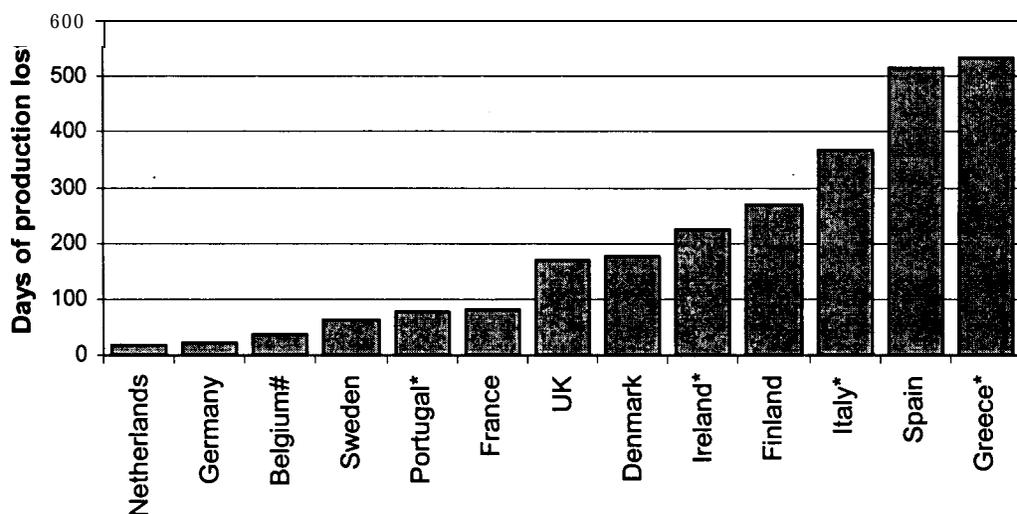
A background for the creation of the Wassenaar agreement **can** be found in the “sense of **urgency**”-**feelings** that arose in the beginnings of the eighties. The WRR and several **committees** wrote alarming reports about the **state** of the economy. A contributing factor to these “sense of **urgency**”-**feelings** is the **fact** that policy makers know that the Netherlands are a small open economy and therefore **rather** vulnerable in an international **economic** context (also see Katzenstein, 1985). The policy makers are aware of the **fact** that they don't have the possibility of **protectionism** to guard their industries. The Netherlands are too small to have an impact on world economy, so it is the Dutch **who will** have to change **when** the **economic** environment **changes**. This forms another element that **forced** the Dutch to develop **problem solving** ways of decision **making** and **inter** organisational **co-operation** between government and social partners in order to **reach** consensus about adjusting to changing **economic** environments in flexible ways.

Policy measures

It is interesting to see **how** the theoretical considerations regarding the model of the labour market of **section 4** **relate** to the three **main** policy measures that are held responsible for the Dutch miracle. First, the most important, as stated before, was the policy of wage moderation in combination with the **promise** of employers to **invest** in employment. This **can** be seen as the clearest example of a **long-term** view of social partners and of a situation in which bargaining power has not been used to disturb the distribution of rents. The **fact** that social unrest, in the form of **strikes**, was extremely low by international standards (see **figure 6**), **can** be seen as a **proof** that labour relations were healthy even **after** two decades of sustained wage moderation.

⁷ Since 1982 the government still has the right to **proclaim** a **ceiling** on wage **rises**, but the **law** only allows for these wage interventions in case the interests of the national economy require intervention because of sudden external shocks to the economy.

Figure 6: Annual average of production days lost by strikes, per 1000 workers (1982-1998)



Source: CBS. # missing data for 1982-1984, 1986, 1987. * missing data for 1998.

The second important cause is found in the flexibilisation of the labour market. Notice that both the first and second cause found support or maybe even originated in the Wassenaar agreement. Although unions used to oppose flex work, during the eighties and nineties they reached consensus with the employer organisations as how to organise the rights and duties of flex workers. In 1999, a law on “Flexibility and security” came into force, which provides a legal protection for flex workers. This attitude of willingness to adapt to a changing environment is one of the reasons that flex work took a high flight in the Netherlands. Between 1970 and 1996, the number of part-time jobs increased with 1.2 million to 1.8 million and the number of flexible jobs increased with 500,000 in this period, whereas the number of full-time jobs stabilised at 3.7 million (Hartog, 1999). The opportunity for flex work thus made a huge increase in employment possible. Again, consensus between social partners and government were the basis of this development.

Reforms in social security are considered as the third cause. They lowered the replacement rate and thus stimulated the search for work. Furthermore, they had a positive impact on government finances, and thereby on taxes and insurance premiums. The lowering of taxes and premiums was used as support for the policy of wage restraint. Social partners, however, played a more dubious role in the field of social security. Attempts of the government to create financial incentives for sick and disabled workers to start working again, have been systematically countered by social partners. Decreases of the benefit level were all “repaired” through collective labour agreements⁸. Social partners also frustrated policies that were meant to curb the volume of benefit recipients. By having a majority in the managing boards of the organisations that were responsible for the implementation, administration and control of the social security system, they were able to grant easy access to benefits. The disability scheme became a “dump” for less productive workers. This was an easy way for employers to substitute older workers for younger, better-trained and cheaper ones, because employees preferred the structural higher benefits of the disability scheme above those of unemployment,

⁸ Although the benefit level in case of sickness declined from 80 percent of the normal wage to 75 percent in 1985 and to 70 percent in 1986, collective agreements made sure that sick employees received a benefit level of 100 percent from the first day of sickness.

and the bill was paid by society as a **whole**. Reforms in 1994 and 1996 created a privatised Sickness Insurance programme for employees. In 1995, as a “punishment” the administration and operative **control** of unemployment, sickness and disability insurance was taken out of the hands of social partners and given to independent institutes. Yet, high social security expenditures for sickness and especially for disability (WAO) still **constitute** the major dark side of the success of the Dutch Polder model. This problem will even aggravate in future with the **further** rise in labour participation and the greying of the working age population (see **Scientific Council for Government Policy**, 2000; Den Butter and **Hazeu**, 2001). It is the Donner-committee, referred to earlier, which has the task to initiate genuine institutional reform that will get **sufficient** political support and support from the social partners.

6. Conclusion

In an international perspective, the Dutch economy has shown a remarkable record of employment and welfare growth, starting in the beginning of the eighties. This paper argues that the Dutch culture of consensus formation constituted a major driving force for this **miraculous economic** recovery. The institutional framework for **social-economic** policy preparation displays various features that are in line with theories about trust-formation in networks. Trust between the foremen of government and social partners have led to **co-operative** long-term views on the **economic** problems, which provided ample societal and political support for **drastic** policy measures. In this way, the Dutch institutional **framework**, with its **specific** formal and informal consultation **structure**, has **functioned** as an intermediary between trust at the **micro** level and macroeconomic performance of the country. The way in which the interaction between scientific **economic** analyses and policy **making** is organised, contributed to a major extent to the formation of trust and hence to societal support for policy measures that were instrumental in the **economic** recovery.

Of course, our paper is narrative in the sense that it describes the link between the success of the Polder model and the role of networks, trust and institutions by a one case-study only. So our study cannot be regarded as an empirical test of the **relevance** of the theoretical argumentation. As a matter of **fact**, **such** empirical test seems not feasible anyhow in discussions of the influence of institutions on macroeconomic performance. There are no “winning” institutional models as the social and historical background is different for **each** country (see **Freeman**, 1998).

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