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Can the Dutch hawk turn into a dove?

The new government has shed its 'frugal' attitude to fiscal policy. That's less about solidarity with southern Europe than realignment with Germany

After the longest coalition negotiations in Dutch parliamentary history, a new government was finally sworn in on 10 January 2022. While Mark Rutte returns to head his record fourth government, one of the more eye-catching changes was the appointment of Sigrid Kaag as minister of finance. Kaag is leader of the liberal-democratic and pro-European D66 and one of the winners of last year's elections. Now, the big question is if her pro-EU credentials will also translate into a different approach to the eurozone?

In recent years, the Netherlands has become known as the unofficial leader of a group of 'frugal' EU member states. The government's tough negotiating stance over the EU's multiannual budget, a lukewarm attitude towards the EU recovery fund in 2020 – which was set up to kickstart the economic recovery after the Covid-19 pandemic –, and a principled position on the Stability and Growth Pact have given the Netherlands the reputation of a fiscal hawk. Prime Minister Mark Rutte famously took a biography of Frédéric Chopin to read during an EU budget summit. Earlier, he even quipped that he carried a 'loaded gun' to such budget talks.

This approach to eurozone issues is reflected in Dutch domestic politics. There is widespread opposition to any move towards a 'transfer union', the Dutch parliament holds a sizeable Eurosceptic cohort, and in 2019 a parliamentary majority called on the government to remove references to 'ever closer union' from the EU treaties.

At the same time, the Netherlands is a founding member of the European communities, and contrary to – say – the Danes, the Dutch have adopted the euro as a currency and enjoy no policy opt-outs. It is the fifth-largest economy of the EU with a major stake in the functioning of the internal market.

Who is Sigrid Kaag?

Dutch financial policy will now be set by a committed pro-European. And from Paris to Athens, expectations are high that she will turn the Dutch fiscal hawk into a dove.

One thing is certain, there will be a change of tone. As leader of the Liberal Democrats, Kaag has come to embody her party's pro-European DNA and she has openly campaigned for a more constructive – some would say federalist – approach to Europe. The new coalition agreement bears her fingerprints. It states that the Netherlands wants to play 'a leading role' in Europe. The Dutch finance ministry plays an over-sized part in shaping the Dutch approach to the EU. That puts her at ground zero to bring about that change.

A change of tone from the Dutch is welcome, but The Hague will not shed its hawkish feathers easily.

On fiscal-monetary issues, the goalposts have also moved. The Dutch objective is no longer to lower government debt and reign in spending. The new government's domestic investment plans – particularly in the areas of climate transition, digitalisation, housing, education, and defence – are substantial. It marks a fundamental shift away from the austerity politics of the mid-2010's. Dutch deficit spending may even cause Dutch government debt to exceed 60 percent of GDP in the coming years. So much for being 'frugal'.

The chances and limits of EU fiscal reform

Other welcome news for southern Europe is that the new coalition agreement has opened the door to reform the Stability and Growth Pact. Many southern member states argue that the eurozone needs spending rules that are more flexible to loosen the fiscal millstone around their necks. The Dutch government accepts that modernisation is necessary and aims to promote 'upward convergence and sustainable debt levels'. The French EU presidency in the first half of 2022 has put this issue on the agenda. Apparently, there is room to negotiate.

But despite this initial enthusiasm in southern European capitals, less may change than they expect. A change of tone from the Dutch is welcome, but The Hague will not shed its hawkish feathers easily. Low interest rates and a healthy balance sheet mean that the Netherlands has a

lot of fiscal space for its new spending plans. The Covid-19 pandemic also demands stimulus spending. This favourable fiscal environment will make it easier for Kaag to show more flexibility in Eurogroup meetings. But this is temporary, not structural. In other words, if ever there was a time to show greater understanding towards southern European concerns, it would be now.

Though Dutch deficits will rise, they will be nowhere near the debt-to-GDP ratios of France, Spain, Italy, or even Germany. Besides, in return for its support to reforming the Stability and Growth Pact, the Dutch will insist on other changes. Expect more enforcement and oversight conditionalities as the price for Dutch flexibility.

The Dutch's realignment with Germany

Rather than moving closer to southern Europe, the new Dutch government is seeking realignment with Germany. The Netherlands and Germany have always been close on eurozone matters. Successive Dutch ministers of finance had a very good working relationship with Wolfgang Schäuble. But when the new German government took office in 2018, The Hague wrongly assumed it would be 'business as usual'. The Franco-German Meseberg declaration in 2018, which announced the development of a common eurozone budget, took the Netherlands by surprise. Even though the Meseberg proposals were eventually watered down, it signalled a degree of separation on eurozone issues between Berlin and The Hague.

In 2020, that divergence gave way to disagreement. Olaf Scholz, then-minister of finance, was openly critical of his Dutch colleague Wopke Hoekstra after the latter called on the European Commission to investigate why countries in southern Europe were ill-prepared to deal with the exogenous shock of the Covid-19 pandemic.

A first test will be the question of applying to the European Commission for Covid-19 recovery funds.

The Netherlands traditionally sees the EU less as a political project and more as a market. Financial-economic issues are seen in isolation, and less as a function of broader political considerations. While Germany shares Dutch concerns about unsustainable debt levels in the South and is resistant to move towards a fiscal union, Berlin also feels a historic responsibility to keep the EU together. Recently, it has meant that Dutch and German eurozone policy have grown out-of-sync. Kaag will now oversee a policy correction that is overdue.

A first test for Sigrid Kaag

The Dutch coalition agreement resonates Germany's. The Netherlands now acknowledges that the European Union is also a community of values. The words it uses to describe Dutch support for modernisation of the Stability and Growth Pact echo the relevant paragraphs in the German coalition agreement. Its massive spending programme on climate transition is in line with the German government's ambitions. Besides, the Dutch government will strongly support Berlin's premise that the EU recovery fund is temporary and limited. Kaag will agree quickly with her German counterpart that there are no blank cheques on eurozone reform, even if she embraces the language of flexibility.

Of all the relationships that minister Kaag will develop, perhaps the most interesting one is between her and minister Christian Lindner. Though Lindner and Kaag come from the same European political family, they hail from different wings and they play different roles in their respective cabinets. While Lindner is a fiscal hard-liner, his social-democratic and Green coalition partners will push him to show more flexibility inside the EU. By contrast, Kaag is the most senior advocate for EU solidarity inside a Dutch cabinet that retains many of its frugal instincts. How Kaag and Lindner work together may go a long way in shaping the debate on the future of the eurozone.

A first test will be the question of applying to the European Commission for Covid-19 recovery funds. The Netherlands is the last EU member state to submit its proposals, which could amount to €6bn. But the funds come with strings attached. To receive them, the Netherlands will have to accept reforms to its labour market and mortgage system.

If Kaag decides not to apply for the funds, other capitals will point to the familiar sight of a Dutch finance minister dismissing EU solidarity. They will argue that the Dutch do not want to take the same medicine they happily prescribe to others. 'A leading role' in the EU it would not be. If Kaag does apply for the funds, she faces criticism at home for bowing to EU demands and giving 'Brussels' a greater say over Dutch finances. She should take heart that even Germany applied for similar funds, and do so too. The proposal is due before the summer. Only then will we get a real sense whether a hawk can change its feathers.



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