The role of public debt management as an instrument of monetary policy in the Netherlands has been greatly reduced since budgetary policy came under heavy pressure in the 1970's. In the Netherlands these two areas of economic policy are intimately related. Debt management is executed by the budgetary policy-maker, whose recourse to the capital market can exceed or fall short of the total borrowing requirement in order to absorb or create liquidity. The Netherlands Bank does not conduct open-market policy in the capital market, nor does it hold a significant portfolio of long-term government securities.

The general theme of this paper is the importance of medium-term control over the public finances as a prerequisite for the feasibility of debt management policy. The theme is developed through a systematic analysis of the determination of the public debt since the advent of Structural Budget Policy in the early 1960's. Under that budgetary policy, the deficit financing strategy followed a regular anti-cyclical pattern, in addition to the a- or even anti-cyclical orientation of the policy determining the deficit itself. A controlled development of the public finances over the medium term was a prerequisite for the feasibility of both these stabilizers. However, in the 1970's this prerequisite increasingly failed to be satisfied, which in effect led to the loss of debt management as an instrument of short-term monetary management.

The insights obtained from an understanding of that experience may assume practical value again in the foreseeable future, as medium-term control over the public finances is regained and on-going financial innovation enhances the merit of additional instruments for monetary management.1

In addition, several aspects of the paper may make it of broader interest. First, the Netherlands is a typical small, open, industrialized economy. An understanding of Dutch experiences may yield insight into problems of a broader

* International Monetary Fund, Washington D.C. 20431, U.S.A. The author thanks J. Boughton, L. Bovenberg, D. Hendry, P. Masson, J. Muellbauer, and the referees for comments on earlier versions. However, the views expressed are his alone and do not necessarily represent those of the International Monetary Fund.

1 In fact, current development along these lines are noted in the Netherlands Bank Annual Report 1985 (pp. 22, 103–4).
set of similar countries. Second, the Netherlands occupies a special position in that for prolonged periods of time its budgetary policies have followed stable and well-publicized rules. The Dutch Structural Budget Policy, briefly summarized in section 1, has received international attention (Dixon 1972, Chand 1977, and Diamond 1977), but the monetary aspects of that policy have not been systematically assessed. A thorough understanding seems all the more relevant now that voices are heard that favor similar rules for major economies such as the United States, Canada, and the United Kingdom (Wildavsky 1983, Peacock 1985). Finally, the analysis of debt policy during the 1960’s presented in this paper explains why the Barro (1979) model of public debt creation has been found not to apply to that period (Kremers 1983). This may be a factor in other countries with active debt management as well.

The paper is organized as follows. Relevant aspects of Dutch fiscal and monetary policy are briefly summarized in sections 1 and 2, respectively. Section 3 offers an analysis of debt management policy during the 1960’s. The transformation of this policy in the 1970’s is discussed in section 4.

Throughout the paper the distinction between financing deficits by debt and by money creation coincides with that made in the monetary analysis of the Netherlands Bank. Money financing is reflected in the Dutch liquidity concept M2. Debt financing refers to any debt not included in M2, usually called funded debt, issued on the capital market. By over- or underfunding (i.e., by issuing nonmonetary debt in excess or short of the total budget deficit), the central government (the ‘Rijk’) can affect the composition of its outstanding liabilities and thus contribute to monetary policy.

1 DEVELOPMENTS IN FISCAL POLICY

During the 1960’s, fiscal policy was executed along the ex ante rules of Structural Budget Policy (SBP) (Burger 1973, 1975, Den Dunnen 1981b). This policy can be summarized by the objective of a long-run government deficit attuned to the normal private sector saving surplus, after allowance for the desired surplus for development aid on the current account of the balance of payments.

The underlying philosophy of SBP meant that actual deficits were of limited concern. During the 1960’s, both real spending and taxation reacted to real national income growth with a positive impact elasticity. The elasticity of

2 For similarities in excessive public indebtedness in Belgium and The Netherlands, see Moerman and Vuchelen (1985) and Benelux (1986).
3 M2 is defined as the sum of notes and coin, demand and time deposits, liquid savings, foreign exchange balances, and short-term claims on the public authorities insofar as held by the general public. However, various corrections are normally applied; see Fase (1977, 1985). Public debt of a maturity of up to five years was included in M2 until 1986, but this has subsequently been reduced to the same maximum maturity as that of included private instruments: two years.
4 This summary is based in part on Kremers (1985).