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Fiscal Monitoring September Report 2019

A. Assessment

1. Introduction

The Advisory Division of the Council of State has been charged with the independent budgetary monitoring on compliance with European fiscal rules, as referred to in the Treaty on Stability, Coordination and Governance (TSCG) and Article 5 of Regulation 473/2013/EU. It is the task of the independent fiscal monitoring institute to draw up an assessment of whether European fiscal rules are being met. In its assessment, the Advisory Division works closely with the CPB Netherlands Bureau for Economic Policy Analysis. The division of tasks entails that the drawing up of independent economic and budgetary forecasts and analyses are assigned to the CPB. The Advisory Division has been charged with the more normative assessment of compliance with European fiscal rules.

The Advisory Division generally publishes two reports per year, in April and in September. In the reports it provides an assessment of the expected budgetary developments and intentions as adopted by the government in the Stability Programme and Budget Memorandum, respectively.

In the interests of quality and meticulousness in drawing up the assessment, the Advisory Division was able to consult a draft of the Budget Memorandum for the September Report. On the basis of this, the Advisory Division has drawn up a draft assessment, which has been reviewed with the government on the principle of adversarial debate. The Advisory Division has made its final assessment after being informed of the government's response. The government's response is included in full in this report.

This Autumn Report is structured as follows. The report starts with the assessment, in this Section A; see paragraph 3 for the conclusions. Section B provides an explanation of this assessment. The government's response is included in Section C.[1]

2. Assessment under fiscal rules

2.1 European fiscal rules

In the September Report the Advisory Division assesses whether public finances during the current year (in year) and in the forthcoming year (ex ante) comply with European fiscal rules. Since the actual budget balance falls below the maximum

1 Part C is not included in the English translation.

allowable deficit under the Stability and Growth Pact (SGP) of 3% of GDP since 2013, and the criterion for Government debt of maximum 60% since 2017, the rules prevailing under the preventive arm of the SGP are relevant for this assessment. These fiscal rules impose requirements on the development of the so-called structural budget balance. This is the budget balance adjusted for the business cycle and incidental items. The medium-term objective (MTO) for the structural balance deficit is set at a maximum of 0.5% of GDP. If the structural deficit is higher than the MTO the public expenditure rule applies. An assessment must then be carried out of whether public expenditure in the medium term is not rising faster than the estimated potential growth of the economy. Lastly, the Advisory Division believes that a proper assessment also relates to the long-term sustainability of public expenditure, and must therefore include a risk analysis.

In 2019 and 2020, the actual budget balance is expected to remain positive (1.2% of GDP and 0.3% of GDP) and Government debt to fall to 47.6% of GDP in 2020. This is well below the 60% of GDP debt criterion in the SGP. The structural budget balance is expected to change from a surplus of 0.3% of GDP in 2019 to a deficit of 0.4% of GDP in 2020. As a result the Netherlands just about complies with the structural fiscal rule of a maximum deficit of 0.5% of GDP.

Table 1: European fiscal rules data

	2018	**2019**	**2020**
	ex post	*in year*	*ex ante*
Rule in respect of the development of the structural balance (% of GDP)			
EMU balance (actual)	1,5	1,2	0,3
EMU balance cyclical component (EC method)	0,7	0,7	0,6
EMU balance one-off and other temporary measures	0,1	0,2	0,0
EMU structural balance (EC method)	0,7	0,3	-0,4
Expenditure rule			
Adjusted net public expenditure (actual change in %)	4,0	2,0	3,6
Max. allowed growth adjustment net public expenditure	3,8	3,4	4,2
Debt criterion (% of GDP)			
EMU debt	52,4	49,3	47,6

Source: CBS, Statline and CPB, Macro Economic Outlook 2020.

2.2 National fiscal rules

As the independent national budget supervisory authority, the Advisory Division also has the task of making assessments regarding national fiscal rules publicly accessible. Since 1994, trend-based fiscal policy, including income and expenditure frameworks is central.[2] The purpose of trend-based fiscal policy is for

[2] Bos, F., 2008, The Dutch Fiscal Framework; History, Current Practice and the Role of the Central Planning Bureau, OECD Journal on Budgeting, Vol. 8 no. 1, p. 1-42.

political decision-making to be influenced as little as possible by ups and downs in the economic cycle. At the beginning of each new legislative period compliance with trend-based fiscal policy is reconfirmed (usually with some adjustments); as was the case at the beginning of the Rutte III Cabinet. For the duration of the legislative period, the national system of expenditure frameworks establishes a fixed ceiling for each individual year of the total expenditure. For the income side of the budget, the policy-based tax development is set for the entire government term in the so-called income framework. This income framework must be complied with on a cumulative basis for the full government term, but unlike the expenditure ceiling, this does not apply to each individual year of the government term.

Adjustments to the expenditure ceiling and income framework are possible in some predetermined cases.[3] Firstly, so called statistical adjustments, with no effect on the total scope under the expenditure ceiling and the income framework, and without deterioration of the government balance are allowed. Secondly, with the approval of the Council of Ministers, the Minister of Finance can decide to make an adjustment between the expenditure ceiling and the income framework if adherence to a separate expenditure ceiling and income framework leads to inefficient or unintended outcomes. These adjustments must be explicitly explained in the Budget Memorandum.

The Budget Memorandum 2020 reveals that the expenditure ceiling and income framework have been adjusted. The expenditure frameworks are being adjusted due to the Pension Agreement, the (draft) Climate Agreement, an additional housing market package and investments. The aforementioned adjustments mean that in the short and medium term, the Government is taking more room for financial manoeuvrability than provided for in the Coalition Agreement. On balance the expenditure ceiling for 2019 up to and including 2021 will decrease, because there is additional underspending. The price paid for this, the same as last year, is that the previously budgeted intensification cannot be achieved. The ceilings will be increased in the following years. In these later years, this will affect the EMU balance. Moreover, it is evident that within the frameworks, additional public expenditure will be covered by windfalls in healthcare. The Budget Memorandum does not provide further details for this decision. Lower healthcare costs could also translate into lower healthcare insurance premiums for households.

The Advisory Division believes that these adjustments do not comply with the Government's own rules, which stipulate what framework adjustments are possible: statistical adjustments, and in case of inefficient or unintended outcomes. The Advisory Division finds that it is not a case of statistical adjustment. However, the agreements in the context of the Pension Agreement do result in a deterioration of the budget balance and also the sustainability balance.

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[3] See Fiscal Rules 2018-2022, as established by the Rutte III Cabinet, Annex 1 to the Initial Policy Memorandum, 2017.

The Advisory Division also notes that it is not a case in which adherence to a separate expenditure ceiling and income framework would lead to inefficient or unintended outcomes. The Government is adjusting both the income and expenditure frameworks. Moreover, the size of these intermediate adjustments is substantial. The total expenditure framework for 2019 will be reduced by over €4 billion compared with the Budget Memorandum last year and by slightly more than €2 billion for 2020 (see Table 2). The frameworks will be raised in subsequent years. The income framework is also being adjusted.

It is striking that the Government has consciously opted for extra investment and tax relief measures in economically prosperous times.[4]This is pro-cyclical policy that represents a clear violation of the trend-based fiscal policy reconfirmed by the Government. Although adjusting the income and expenditure frameworks at present does not pose a risk to the economy and the health of Dutch public finances, as long as this is actually a one-off, the Government does not explain why it is now necessary to deviate from the principles of trend-based fiscal policy.

The Government is examining how long-term public investments could be increased, like those in education/lifelong learning, innovation and R&D and infrastructure.[5,6]This could be done in several ways, such as in the form of a national investment fund. The Government will inform the House of Representatives on this matter at the beginning of 2020. From the perspective of fiscal policy it is also important to clarify how such an investment fund or other form of investment relates to European and national fiscal rules.

When assessing the draft Budget Memorandum with regard to national fiscal rules, the Advisory Division devoted special attention to the Pension Agreement and the Climate Agreement.[7]The Advisory Division points out that there are still loose ends regarding the fiscal implications of both Agreements. In the Pension Agreement relinquishing the link between the increase in the state retirement age and life expectancy has not been elaborated in legal or technical fiscal terms. At this stage it is uncertain whether the CO2-reduction goals of the Climate Agreement, to which the Netherlands is committed, will be achieved; if not, additional policy could be necessary and this may lead to further costs and burdens.

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[4] Budget Memorandum, p. 28
[5] Budget Memorandum, p. 19 and 20.
[6] The advice issued by the Advisory Division on the Budget Memorandum demonstrates that there may be good reason to focus more on capital investments compared with other expenditure categories. In Section B, paragraph 3 of this report, the Advisory Division requests attention be devoted to income and expenditure respectively, a capital service approach (in addition to or instead of possible fund development).
[7] See Section B, paragraph 1.2.

3. Conclusion

This leads the Advisory Division to draw the following conclusions:

a. Based on forecasts by the CPB, the Advisory Division concludes that the public finances of the Netherlands are expected to remain within the limits of the European fiscal rules in 2019 and 2020.
b. Based on the Budget Memorandum, the Advisory Division concludes that the budget does not comply with national fiscal trend-based policy including expenditure ceilings and income framework.
c. The Budget Memorandum is open ended where it concerns elaboration of the Pension Agreement, the Climate Agreement, and a possible investment fund.
d. It is precisely in times of (above) average economic growth that measures must be taken to make Dutch public finances and the economy more stable (to prevent pro-cyclicality of fiscal policy). In Section B, paragraph 3, the Advisory Division examines ways to reduce pro-cyclicality of fiscal policy, with suggestions related to financing municipalities, the housing market and financing public investments.

4. Previous Government commitments based on reports

The Government has made three commitments in response to the Advisory Division's recommendations in previous reports:

a. To monitor risks and examine the most suitable form and frequency of reporting on this matter;[8]
b. To examine which method is possible to increase transparency of reporting regarding the development of tax and social security premiums;[9]
c. To increase transparency of healthcare expenditure forecasts.[10]

The Advisory Division has recommended addressing uncertainties and risks related to public finances in the Budget Memorandum. The Government subsequently indicated that attention was devoted to these risks in the Budget Memorandum and that a shock impact assessment had been included in the previous Budget Memorandum. The Government has committed to analysing the most suitable form and frequency of reporting on this matter, but in this Budget Memorandum no conclusions are included. There is also no shock impact assessement included in the Budget Memorandum, although attention is devoted to uncertainties and risks.[11]This analysis is not yet of a systematic character. At present, the uncertainties for the Dutch economy are high and the risks are mainly downward. This could also have serious consequences for the Netherlands' public finances. This is explained in more detail in paragraph B.2. Therefore, the brief impact test analysis from the previous Budget Memorandum should have been expanded in this Budget Memorandum.

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[8] Spring Report 2019, Section C, Government response, p. 20.
[9] Spring Report 2019, Box 1, p. 16.
[10] Spring Report 2019, Section C, Government response, p. 21.
[11] See, for example, paragraph 1.1.

In the Autumn Report 2018, the Advisory Division pointed out the importance of providing greater insight into the development of taxes and social insurance premiums, in which special attention must be devoted to the difference between horizontal development (year on year development) and vertical development (difference for the same year between the different occasions on which a forecast was produced). The Government has committed to take this recommendation to heart and to examine how it can best be achieved in the future, to provide a picture that is as transparent as possible. The Budget Memorandum indicates that, in order to increase comprehensibility and consistency, the CPB and the Ministry of Finance are in the process of developing a new, joint definition of policy-related development of taxes and social security premiums.[12]However, this has not yet resulted in a different presentation in the Budget Memorandum for 2020; hence there is still insufficient insight.[13]

Given the major share of healthcare in total collective expenditure and the difficulty in managing its growth, in the 2019 Spring Report the Advisory Division recommended work be continued on improving healthcare forecasts. The Budget Memorandum explains why healthcare expenditure forecasts are a complex issue and that there are more reasons why their provision is delayed.[14] Consequently a cautious first step has been taken in the problem analysis, but no specific improvements in the system of these forecasts are in sight.

B. Explanation

1. Budgetary prospects

1.1. General picture

The Dutch economy is expected to continue to grow in 2020 with a growth rate (1.5%) that is still above the European average but lower compared to previous years. These figures mean that the Dutch economy is performing relatively well compared with the eurozone as a whole. The large economies in the eurozone display serious growth slowdown, and further economic uncertainties on the international playing field are resulting in downward risks. In addition the global economy in general and the eurozone in particular find themselves in uncharted territory with the long-term, extremely low interest rate.

Fiscal policy for 2019 has not changed dramatically. An actual balance of 0.2% of GDP is forecast for 2020. The structural balance will turn into a deficit of 0.4% of GDP in 2020. The downward debt development in recent years will also continue, albeit less significantly. This is due to major, recent political decisions, such as the decision to implement additional investments and tax-relief measures, departing from trend-based fiscal policy.

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[12] Budget Memorandum, p. 43.
[13] See Section B, paragraph 1.3.
[14] Budget Memorandum, p. 33-34.

1.2 Expenditure development

The expenditure frameworks are being adjusted. Table 2 illustrates how each framework has changed compared with the previous Budget Memorandum. This is partly the result of underspending, which means the ceilings for 2019-2021 are being reduced. This expenditure is being postponed to 2022-2024.[15] Moreover, the Government proposes to use room below the ceiling for new expenditure, such as that related to the Pension Agreement, the Climate Agreement, an additional housing market package and investments. The aforementioned agreements mean that the Government is taking more short and medium-term financial room than provided for in the Coalition Agreement. It is not directly obvious how these shifts will work out in the long term.

Table 2: adjustment of expenditure frameworks according to BM2020

	2019			2020		
(in billions of euro)	BM19	BM20	Adjustment	BM19	BM20	Adjustment
Total ceiling	293,0	289,7	-3,3	304,3	302	-2,3
State budget	139,4	136,9	-2,5	143,4	142,5	-0,9
Social Security	81,7	81,6	-0,1	84,8	84,7	-0,1
Healthcare	71,9	71,2	-0,7	76,1	74,7	-1,4

Pension Agreement

The Pension Agreement involving the Government, employer and employee organisations results in additional expenditure and less income for the Government.[16] An increase in the State retirement age to 67 years of age in 2024 instead of in 2021 results in €5 billion extra state pension payments (cumulative over these years). To facilitate customisation at the sectoral and CLA level, €0.8 billion is being made available, and the costs for the partial exemption of the Early Retirement Scheme levy amount to €0.2 billion. Adjustment of the one-to-one link of the State retirement age to life expectancy by a two thirds–to-one link results in the deterioration of the sustainability balance by approximately 0.4% of GDP;[17] this effect (circa €3 billion in structural terms) is not yet apparent in this Budget Memorandum.

Fiscal consequences are only covered to a limited degree by the expenditure ceiling and income framework agreed at the beginning of the Government term. Financial cover will be distributed across the next 15 years. The Government argues for the change in the one-to-one link partly by anticipating an adjustment of the CPB's government finance sustainability calculation. According to a partial analysis by the CPB, increasing labour participation is also expected to continue in

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[15] A more favourable balance and debt development during this legislative period will also be followed by a less favourable development of both these elements.

[16] Letter to Parliament on the Agreement in principle of renewing the Pension System, 5 June 2019 and BM2020.

[17] As of 2025, each year by which life expectancy increases will result in an increase of eight months in the State retirement age.

the future and this has a positive effect on sustainability. The CPB will publish the full sustainability calculations before the end of this year.

Climate agreement

The objective of climate policy is to limit global warming by reducing greenhouse gas emissions. To achieve this the Government is preparing a climate plan. Therefore a Climate Agreement was compiled and additional policy was developed (including a CO_2 levy). The Government is striving to keep the energy transition feasible and affordable.

The Government's expenditure will increase in the coming year. Additional expenditure will mainly involve the agricultural sector. In the years following 2025, expenditure in the built-up environment sector will rise, to encourage activities to increase the sustainability of the housing stock.

Table 3: Overview of budgetary effects of the Climate Agreement according to the BM 2020 and TP 2020

Expenditure (BM 2020) (+=extra expenditure prices 2019)	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Built-up environment	400	10	20	30	30	80	80	80	80	80	80	80
Mobility		0	40	45	55	35	0	0	0	0	0	0
Agriculture		140	160	80	40	40	30	30	30	30	30	30
Industry		0	25	25	25	50	0	0	0	0	0	0
Electricity		0	0	0	0	0	0	0	0	0	0	0
Total	400	150	245	180	150	205	110	110	110	110	110	110
Income (TP 2020) (+=tax burden, prices in the year of introduction)												
Built-up environment		-345	-425	-425	-425	-425	-425	-425	-425	-425	-425	-425
Mobility		43	-314	-368	-348	-441	-682	-32	122	141	176	134
Electricity			-64									

On balance climate policy will also result in tax-relief measures in the coming year. In particular, the shift from taxes to companies and measures related to electric cars will reduce the burden on citizens in the coming year. In other words, the additional budgetary and fiscal effects of the (draft) Climate Agreement provided for in this Budget Memorandum collectively amount to just under €0.5 billion.

There is also a CO_2 levy, but this is still being elaborated and will not yet come into effect in the coming year. Moreover, the budgetary effect of the levy is intended to be neutral, since this tax must primarily serve as an incentive to reduce CO_2 emissions. The aim of this levy is not to generate income and the reveneues will therefore immediately be redistributed.

Lastly, a vital consideration is that it is uncertain whether the objectives established in the Climate Act will actually be achieved with the current Climate Agreement. As a result it is not possible to rule out at the moment, that additional policy and corresponding measures will be required.

1.3 Developmentof taxes and social premiums
The income framework is also being adjusted. The income framework governs the policy-related tax development as proposed in the Coalition Agreement. Based on policy implemented by previous governments, the tax burden was approximately €9 billion before this Government term. The Coalition Agreement envisaged relief amounting to €6.5 billion. Last year, the income framework closed and was aligned with the intended development in the Coalition Agreement. A framework adjustment was applied this year. The policy-related tax development is consequently lower than intended at the beginning of the Government term.

The Budget Memorandum, respectively the Tax Plan 2020 package contain new policy (tariff and base adjustments, respectively tax relief), reassessments (compared to the forecast in the Initial Policy Memorandum), new healthcare premium forecasts and, as previously argued, the tax effects from the Pension Agreement and the Climate Agreement. These are all relevant to the income framework.

Although it is clear that the government aims on balance to achieve additional tax reductions for households, it is difficult to obtain an effective overview of all the adjustments. Furthermore, there are shifts between income and expenditure. The concurrence of these adjustments does not benefit the transparency of the budget and detracts from the Government's fiscal rules, as explained further in paragraph 2.2.

2. Uncertainties and risks

Despite the greatly improved health of Dutch public finances since 2013, the uncertainties and downside risks are considerable. For example, a chaotic no-deal Brexit could reduce economic growth in the Netherlands this coming year by 1% point.[18]The downward risks to the global economy and the eurozone are significant.[19]Government debt is currently below 50% of GDP. However, in the event of a subsequent financial crisis, government debt could increase considerably once more and end up far above the European debt criterion of 60% of GDP. In addition, the long-term, persistent low interest rate causes uncertainty. The eurozone in particular finds itself in uncharted territory in this regard.

Data from recent national and international research could substantiate the downside risks for Dutch public finance. The increase in Dutch government debt by 25% of GDP during the previous financial-economic crisis is significant from a historical perspective, but is not unique in the Netherlands.[20]The debt ratio increased more substantially during the economic crisis that followed the oil crisis in 1973. According to recent research by the International Monetary Fund (IMF) a

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[18] CPB, 2018, December forecast: Economic Outlook 2019, CPB Policy Brief December 2018, p. 7.
[19] MEV2020.
[20] Lukkezen, J. and W. Suyker, 2013, Naar een prudent niveau van de overheidsschuld, (Towards a prudent level of government debt) CPB Policy Brief 2013/05.

financial-economic shock could increase government debt in small-scale, open economies like that in the Netherlands by 40% of GD.[21]In order to be prepared for this kind of shock, the target debt ratio in Sweden has been reduced from 35% of GDP to 25% of GDP, with a margin of plus or minus 5% of GDP. According to Swedish economists this prudent debt criterion is good for economic growth in the long term, and certainly does not compromise adequate public investment.[22]This has been demonstrated by the Swedish experience, where strict fiscal policy has been implemented during the past 25 years.

Paragraph 2.1, Section A, already points to the fact that the fiscal implications of the Pension Agreement and the Climate Agreement, and a potential investment fund or other investment incentive, represent loose ends with regard to the multi-year budget and therefore also risk for government debt.

3. Making fiscal policy less pro-cyclical

As stated in this, and the previous report, Dutch public finance complies with European fiscal rules. This suggests that the fiscal policy is in good order and that few policy adjustments are needed in this regard. However, there are reasons why we should not rest on our laurels.
Firstly, the financial and economic crisis between 2008 and 2013 has taught us that a substantial buffer in public debt is required in order to absorb the blows of such a crisis. Secondly, the decrease in government debt in all eurozone countries is partly due to the extremely low interest rate. Thirdly, this Government's fiscal policy is expansive.[23]

At the same time, the decline in the Dutch economy in recent years was deeper due to pro-cyclical elements in the fiscal policy. In particular in times of prosperity policy measures should be taken to remove such pro-cyclical elements. Taking these kinds of policy measures is an urgent matter, because a change in the economic cycle can occur quickly and unexpectedly.

Below, three topics are discussed that could make Dutch fiscal policy more stable and less pro-cyclical: the financing of municipalities, the housing market and financing of government investments. However, we first briefly explain why the practice of trend-based fiscal policy often deviates from the theory.

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[21] Laeven, L. and F. Valencia, 2018, Systematic Banking Crises Revisited, IMF Working Paper WP/18/206.

[22] Andersson, F. and L. Jonung, 2019, Fiscal policy is no free lunch: Lessons from the Swedish fiscal framework for fiscal targeting, VOX EU, 5 June 2019. This policy was implemented after the Swedish economy stagnated in the early Nineties and government debt had risen to 75% of GDP.

[23] On balance the financial framework of the prevailing Coalition Agreement includes a boost of €14.5 billion. Moreover, the Budget Memorandum 2020 adjusts the expenditure frameworks once more, partly as a result of the Pension Agreement. This means a change in the actual balance from a budget surplus of 1% of GDP in 2019 to an expected deficit of 0.4% in 2024.

Theory versus the practice of trend-based fiscal policy
Trend-based fiscal policy can be loosely summarised as 'taking it easy'.[24]This implies that in times of economic headwind cutbacks or increasing taxes should be absent or moderate. However, this is only possible if, in normal economic times, and especially during an economic boom, a cautious approach is also taken towards additional expenditure and extra tax-relief measures. The aim of trend-based fiscal policy is to ensure the solvency of public finances and economic stability, and to use the government debt to absorb macroeconomic shocks. Increased stability and less uncertainty promote the quality of public and private decision-making and avoid adjustment costs for citizens, businesses and government institutions.

Dutch trend-based fiscal policy is assessed as good to very good by the Organisation for Economic Cooperation and Development (OECD).[25]Nevertheless, the implementation of trend-based fiscal policy in practice was repeatedly found to be difficult and conflicted with the basic principles of this policy on several occasions.[26]Instead of stabilizing the economic cycle, Dutch fiscal policy proved to be repeatedly pro-cyclical. There were diverse reasons for this. At times a deliberate decision was taken to prioritise improving public finances and reduce government debt above the objective of the stabilisation of trend-based fiscal policy, partly to stay within the rules of the SGP and maintain the trust of the capital market. A number of other cases concerned zigzag policy first with budget cuts, followed by extra expenditure, such as in long-term care and childcare.[27] The timing of some policy measures was also unfortunate, such as on the housing market. The same applies to the 'automatic' cuts in the central government transfers to municipalities via the Municipality Fund.[28]

Therefore, trend-based fiscal policy is designed to be anti-cyclic. Apart from the fact that it is difficult for politicians to adhere to trend-based fiscal policy, there may also be elements in the budgetary system that have an unintended pro-cyclical effect, and there are policy areas that by their nature contribute more than average to unintended pro-cyclicality. Below we discuss the financing of municipalities, the stability of the housing market and the financing of government investments from this perspective.

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[24] NRC Haagse Zaken, podcast 29 June 2019.
[25] Report by the 15th Study Group on Fiscal Policy, 2016, paragraph 2.2.
[26] Suyker, W., 2016, Opties voor begrotingsbeleid, (Options for fiscal policy) CPB Policy Brief 2016/02.
[27] CEP 2019, p. 18.
[28] Bos, F. and W. Vermeulen, 2019, Financiering Rijk maakt gemeente-investeringen procyclischer (Central government financing makes municipal investments more pro-cyclical), ESB, 104 (4773), 9 May 2019.

More stable financing for municipalities

The main source of funding for municipalities are the transfers by the central government via the Municipal Fund. This funding is volatile[29] due to the so-called step up, step down system As a result, major increases or reductions in municipal revenues are not directly connected to municipal tasks. This volatility in municipal revenues causes unrest and uncertainty and is bad for the quality of decision-making by municipalities, including municipal investments. The step up, step down adjustments by the Municipal (and Provincial) Fund are also pro-cyclical at the macro level and thus inflict further damage on the Dutch economy, e.g. by halving municipal investments during the financial-economic crisis.

There are different ways to stabilize municipal financing and thus reduce additional damage on the Dutch economy at the same time. Examples include linking the central government's general transfer to municipalities to a fixed volume growth percentage and a forecast of the Consumer Price Index (CPI), or using an indexation based on gross public expenditure.[30]Four-yearly fixed frameworks (amounts) for the Municipal Fund (and the Provincial Fund), at the beginning of a Government term, would also avoid annual 'step up, step down' disruptions. Funding part of the municipal investments using a separate fund is another option. Moreover, various proposals have been put forward for higher municipal taxes. This could also reduce the dependence on the volatile and procyclical funding by the central government and replace this partly be more stable municipal tax revenues.[31] According to the OECD, the local property tax (OZC) is a stable and not particularly disruptive source of income.[32]

The Budget Memorandum announces that financing mechanism of the Municipal and Provincial Fund will be evaluated in the run up to the Study Group on Fiscal Policy.[33] The aim is to arrive at a variant of indexation. The Advisory Division endorses the need for such an evaluation, but advises not only to look at variants

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[29] Bos, F., 2018, Waarom zijn de gemeente-investeringen sinds 2009 sterk gedaald?, (Why have municipal investments fallen significantly since 2009?) CPB Memorandum 11 July 2018, paragraph 3.3.

[30] Zeilstra, A. and K. Martens, 2015, De indexeringssystematiek van het Gemeentefonds in het licht van de decentralisaties en demografische ontwikkelingen. (The indexation system of the Municipal Fund in light of decentralisation and demographic trends.) CPB Memorandum, 22 September.

[31] For a response by the Advisory Division to these proposals see: "En nu verder! Vierde periodieke beschouwing over interbestuurlijke verhoudingen na de decentralisaties in het sociale en fysieke domein," ("Let's move on! Fourth periodic consideration of inter-administrative relationships after decentralisation in the social and physical domain," paragraph 4.6 Financing and financial relationships (Advice issued 30 September 2016; Annex to Parliamentary Papers II 2016/17, 34550-VII, no. 12).

[32] Blöchliger, H., 2015, Reforming the tax on immovable property: taking care of the unloved. OECD Economics Department Working Paper, 1205.

[33] Budget Memorandum, p. 40.

of indexation but also at other alternatives, such as an increase in municipal taxes and the countercyclical practice of financing municipalities in Denmark.[34]

More stable housing market

The Dutch housing market is relatively cyclical compared with other countries.[35]The large upward and downward fluctuations in Dutch house prices also have a destabilizing impact on the Dutch economy. The recovery of the housing market has accounted for a quarter of the growth of the Dutch economy as a whole since 2013. A reverse effect occurred when the housing market collapsed in the years before. A broad package of measures is needed to make the Dutch housing market more stable.

First of all, it is important to increase the supply of housing, especially rental housing in the mid segment. This reduces the structural shortage of homes and increases options for households. A significant increase in the supply of rental housing in the mid segment could serve as a pressure valve for social housing and owner-occupied homes. This facilitates fluidity and, as a result, many types of house hunters can benefit, from first-time buyers to elderly people that want to capitalise on the surplus value of their home, and people that want to work in a different region.

A proper and effective role of housing corporations is also important. In the Netherlands, housing corporations manage 2.3 million dwellings; this represents 30% of the total housing stock.[36] Due to rising house prices and the surrender of annual central government subsidies in 1995, housing corporations have become rich; the landlord levy was introduced to cream off this capital from housing corporations. However, the timing was rather unfortunate because it ultimately coincided with the financial crisis.[37]

To achieve a stable housing market you also need stable and prudent financing of the housing market. However, compared with other European countries, the Netherlands still has a relatively high mortgage debt: in 2009, it was 110% of our national income (GDP) and has now fallen below 100%. The introduction of the maximum loan-to-income ratio, lowering the maximum loan-to-value ratio, and limiting the mortgage interest deduction to mortgages with annuity and linear

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[34] Zeilstra, A. and K. Martens, 2015, De indexeringssystematiek van het Gemeentefonds in het licht van de decentralisaties en demografische ontwikkelingen. (The indexation system of the Municipal Fund in light of decentralisation and demographic trends.) CPB Memorandum, 22 September.

[35] Yannick Hemmerlé (DNB), 2019, Nederlandse economie volatieler dan buurlanden (Dutch economy more volatile than its neighbouring countries), ESB 1 August 2019. Knot, K., 2019, De woningmarkt in macro-economisch perspectief, DNB. (The housing market from a macroeconomic perspective, DNB).

[36] Ministry of the Interior and Kingdom Relations (BZK), 2018, p. 17.

[37] One remarkable aspect is that according to housing corporations, insufficient own financial resources does usually constitute the main reason for failing to achieve new construction plans. The bottleneck is primarily a lack of locations with cheap land. Michielsen et al., 2019, p. 32.

repayment appear to have contributed to this.[38]It is a positive development, but this debt is still relatively high and an important explanation for the erratic and volatile nature of our housing market and economy.

In the Budget Memorandum there is a prominent focus on the accessibility and stability of the housing market.[39] It cites the causes of the tightness of the housing market and the policy challenges. Diverse policy measures are also taken, such as a State contribution of €1 billion to build affordable homes in scarce areas and lowering the landlord levy by €0.1 billion a year. The Advisory Division recommends elaborating these specific steps from the perspective of the stability of the housing market and the stability of the economy.

Financing government investments
Separate fiscal funds have been set up for investments in infrastructure and the Delta Programme. These kinds of fund constructions could make a contribution to combating pro-cyclical policy if, and insofar as the corresponding expenditure is and remains fixed for a long period of time, regardless of the economic cycle. These funds and associated rules of play, such as multi-year planning and a compulsory cost-benefit analysis, have probably contributed to the good condition of Dutch transport and watersafety infrastructure at a relatively low price.[40] In a sense InvestNL (currently being founded) is also a vehicle outside the annual budget cycle aimed at investments, in this case mainly focused on the climate and energy transition.

The Government is considering additional investment to expand the earnings capacity of the Dutch economy in the long term.[41] The Government is primarily considering investing in knowledge, innovation and R&D and infrastructure. At the end of this year the Government will present an investment agenda and early next year it will be investigated whether and how an investment fund should be set up for this purpose.

In its recommendations on the 2020 Budget Memorandum, the Advisory Division also devoted attention to government investments. It mainly focused on the reduction in these investments over time and their importance for mobility, quality of life and sustainability, and thus for wider prosperity in the Netherlands. The Advisory Division endorses the comments in the Budget Memorandum that a good selection of projects is essential and that lessons can be learned from using funds in the past and current funds for infrastructure and the Delta Programme.

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[38] Groot, S., B. Vogt, K. van der Wiel and M. van Dijk, 2018, Oververhitting op de Nederlandse huizenmarkt? (Overheating on the Dutch housing market?), CPB Background document 1 June 2018, p. 23.
[39] Budget Memorandum, p. 16, 31, 53-56.
[40] Water governance in the Netherlands serves as a model for the rest of the world and with annual public expenditure of 1.3% of GDP, is also relatively cheap (OECD, 2014, Water Governance in the Netherlands: Fit for the Future, OECD Studies on Water).
[41] Budget Memorandum, p. 19 and 20.

The Advisory Division recommends including two more perspectives in the further study announced by the Government. The first is the trend-based fiscal policy, in other words: considering whether elements of a capital service resp. income and expenditure system with a view to (capital) investments could (partly) reduce the pro-cyclical nature of fiscal policy.[42]
The second perspective is the European perspective: how does it relate to European fiscal rules and the debate on Member State deficits and surpluses on the balance of payments?

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[42] See Advisory Committee on the Central Government Reporting System, 2017, Income and expenditure revalued; advantages and disadvantages of the further addition of income and expenditure information.