Raad van State

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# Fiscal Monitoring September Report 2018

## A. ASSESSMENT

### 1. Introduction

As an independent fiscal institution, the Advisory Division of the Council of State is responsible for reviewing compliance with (European) fiscal rules.[1] The Advisory Division works closely with the Netherlands Bureau for Economic Policy Analysis (CPB) in preparing its assessment. The distribution of tasks means that the CPB is responsible for compiling the independent forecasts and analyses; the Advisory Division is charged with the more normative assessment of compliance with (European) fiscal rules.

In general, the Advisory Division publishes a report twice a year, in which it provides an assessment of the expected budgetary developments and the intentions as adopted by the government in the Stability Programme and the Budget Memorandum respectively.

For the sake of the quality and accuracy of the assessment, the Advisory Division was given access to the draft version of the Budget Memorandum for this September Report. On this basis the Advisory Division has compiled a draft assessment, which is discussed with the government in an *audi alteram partem* procedure. The Advisory Division makes its final judgement after being informed of the government's response. The government's response is included in full in this report.

The September Report is structured as follows. The report begins, in this section A, with the assessment. The analytical part that forms the substantiation for the assessment is included in Part B. The government's response is included in Part C.[2]

### 2. Macroeconomic and budgetary outlook

Following a strong growth of 2.9% in 2017, the Dutch economy will continue to enjoy a strong growth this year and next year, according to the latest CPB forecast. Economic growth is expected to reach 2.8% this year, and 2.6% in 2019. These healthy figures mean that the Dutch economy is performing better than the eurozone as a whole. This year the eurozone's economy is expected to grow by 2.1%, and by 1.9% in 2019.

Dutch economic growth is broadly supported. All expenditure categories make a positive contribution to growth. Consumers consume more, businesses invest more. The government's expansionary budgetary policy provides an additional boost. Lastly, the Dutch economy benefits from the favourable global economy, which is expected to grow by 3.8% in both 2018 and 2019.

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1 As referred to in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) and Article 5 of Regulation (EU) 473/2013.

2 Parts B and C are not included in this English translation.

This continued healthy economic growth means that the Dutch economy is experiencing a phase of economic boom. This is also reflected in the labour market, which is displaying signs of shortage. In 2017, 4.9% of the working population was unemployed (438,000 people), in 2018 this will decrease to 3.9% (355,000) and in 2019 to 3.5% (320,000). These low levels were last achieved around the turn of the century.

In 2017, there was a budget surplus of 1.2% of GDP. Despite the economic boom, resulting in considerably reduced unemployment expenditure and higher tax revenues, there will be no further improvement in public finances in 2018 and 2019; both years will be characterised by a budget surplus, of respectively 0.9% and 1.0% of GDP. This is also revealed by the development of the structural budget balance, in which the budget balance is adjusted for the economic cycle and one-off measures. This balance deteriorates from a surplus of 0.8% of GDP in 2017 to a deficit of 0.4% of GDP in 2019, or over 1% of GDP (€ 9 billion) in two years, which reveals that budgetary policy is currently expansionary. At the end of 2017 government debt stood at 57.1% of GDP, which meant the debt was under the threshold of 60% of GDP for the first time since 2010. In 2018 and 2019, the debt will continue to decrease to 53.0 and 49.1% of GDP respectively.

3. Assessment under fiscal rules

In its September Report, the Advisory Division assesses whether Dutch public finances comply with European fiscal rules in the current year ('*in year*') and in the year to come (*ex ante*). Due to the fact that the actual budget balance complies with the maximum allowed deficit of 3% of GDP established in the SGP, since 2013, the 'preventive arm' of the Pact is relevant in the assessment of the rules. It imposes requirements on the development of the structural budget balance (the budget balance adjusted for the economic cycle and one-off measures) and on the development of public expenditure. Furthermore, government debt must be lower than 60% of GDP, or in any case decrease to a sufficient extent towards this percentage.

In 2018 and 2019 the actual budget balance will remain positive, according to CPB forecasts. Consequently, the actual budget balance satisfies the threshold value of –3% of GDP established in the SGP. However, the structural budget balance will deteriorate in both years and change into a deficit of 0.4% of GDP in 2019. Therefore the structural budget balance in 2019 will (just) comply with the lower limit of –0.5% GDP that applies to the Netherlands. Since the structural balance in the current forecasts in 2018 and 2019 continues to comply, the expenditure rule assessment does not need to be taken into account. The expenditure rule demonstrates that the decrease in the structural balance can largely be attributed to the strong growth in expenditure, in particular in 2018. Government debt will continue to decrease in 2018 and 2019. As a result government debt complies with the debt criterion established by the SGP in both years.

The unavoidable fact of uncertainties and risks imposes requirements on the budgetary policy. Bearing this in mind, the current budgetary policy in the Netherlands is notably procyclical from an economic perspective: there is an expansionary budgetary policy in economically favourable times. Government debt may decrease to below 50% GDP in 2019, but the current surplus in the structural budget balance will change into a deficit of 0.4% GDP in 2019. Moreover, there is a sustainability deficit of 0.4% GDP.

Based on the CPB forecast, the Advisory Division concludes that Dutch public finances are expected to remain within the limits of the European fiscal rules in 2018 and 2019. At the same time there will be a deterioration in the structural budget balance as a result of a budgetary impulse, which from an economic perspective does not seem obvious during these current, cyclically favourable years.

As the independent national budget surveillance authority, the Advisory Division also has the task of making publicly accessible assessments regarding compliance with national fiscal rules. The national system of expenditure ceilings sets a fixed ceiling to the total expenditure for each individual year of the government term. For the revenue side of the budget, the policy-related tax development is set in the revenue ceiling for the full government term. This revenue ceiling must be complied with on a cumulative basis over the full government term, but unlike the expenditure ceiling, this does not apply for each individual year of the government term.

From the Budget Memorandum it may be concluded that the expenditure ceilings are complied with for each year of the government's term. The ceiling assessments show that in 2019, the sub-ceiling of the State budget is exceeded, which is compensated by an underspend in the social security and healthcare sub-ceilings. The Advisory Division notes that various expenditure measures in the 2019 budget are covered by windfalls from social security and healthcare. When the extra expenditure is of a structural nature, the question can be raised of whether this also holds for the cover that is sought. This does not appear to be consistent with the basic principle that windfalls may not be used for new policy and also raises the question of how this could be reconciled with the fiscal rules of play.

With regard to the tax development the Budget Memorandum proposes that the 2019 budget satisfies the revenue ceiling.

## 4. A closer examination of public expenditure and tax and national insurance contributions

This and next year public expenditure will continue to increase – in terms of volume – by respectively 2.5 and 1.8%. However, this is not reflected in the gross public expenditure ratio; because the economy will grow faster in both years, the gross public expenditure ratio decreases slightly and amounts to 42.4% of GDP in 2019. Non-tax revenues decrease from 4.7 to 4.2% of GDP. Some of the expenditure measures from the Coalition Agreement budgets for 2018 will no longer be spent this year, but next year. As a result, there will be some substantial additional expenditure in 2019 , notably on defence (+21.4% in 2019) and infrastructure (+10.9%). It proves difficult to spend all budgeted funds, because the extra expenditure mainly take the form of extra employment in the public sector that cannot be easily filled in the current tight labour market.

After defence and infrastructure expenditure, healthcare expenditure will increase most, by 4.5% in 2019. This means healthcare expenditure will increase more rapidly than the economy is expected to grow next year. Admittedly, thanks to the various measures, the increase in healthcare expenditure was somewhat mitigated during the crisis, but healthcare expenditure will increase further as a percentage of GDP during this government's term of office. The consequence is that without any additional policy, healthcare expenditure will also place an increasing burden on public sector funds over the coming years and could restrict other categories of expenditure.

Tax and national insurance contributions will increase in 2019. The total revenue ratio will increase from 38.7% of GDP in 2018 to 39.2% of GDP in 2019. This increase is the result of endogenous tax relief measures on the one hand and a policy-related increase in the tax burden on the other. The endogenous tax-relief measures are the result of the fact that different tax bases increase slower than the economy grows. In contrast, according to the CPB, there is a policy-related increase in the tax burden of over € 5 billion in total; the Budget Memorandum, however, mentions a policy-related increase in the tax burden of € 3.8 billion.

In its Spring Report the Advisory Division has drawn attention to the fact that interpreting the different figures for the development of the tax and national insurance contributions is not always straightforward. The various reports on tax development sometimes refer to year-on-year ('horizontal') changes and sometimes to the development in relation to the situation concerning a previous decision-making point in time ('vertical'). The horizontal development is relevant in social and economic terms, because it offers an insight into the tax development experienced by families and businesses year-on-year and the potential spending effect on the economy. However, it is the vertical development that is relevant to the political debate and for parliamentary approval. The Advisory Division finds that in this Budget Memorandum and corresponding appendixes, an attempt has been made to increase transparency of the tax development and that an improvement has been made in this regard. At the same time, it finds that the figures for the policy-related tax development in the Budget Memorandum differ somewhat from those of the CPB (difference of € 1.5 billion in 2019) and are still difficult to interpret. Where the explanation for this can be found in differences in definitions between the Ministry of Finance and the CPB, the Advisory Division recommends this aspect be explained in the Budget Memorandum; a harmonisation of definitions is required over time.

## 5. Conclusion

In the light of the findings and conclusions, as well as the response from the government on the draft assessment, the Advisory Division of the Council of State presents the following assessment.

I. Based on the CPB forecast, the Advisory Division concludes that Dutch public finances will remain within the limits of the European fiscal rules in 2018 and 2019, according to expectations. At the same time there will be a deterioration in the structural budget balance as a result of a budgetary impulse, which from an economic perspective does not seem logical during these current, cyclically favourable years.

II. Based on the Budget Memorandum the Advisory Division concludes that the budget complies with the national budgetary framework of the expenditure ceilings and the revenue ceiling. However, the Advisory Division notes that the various expenditure measures in the 2019 budget are covered by windfalls from social security and healthcare. When the extra expenditure is of a structural nature, the question can be raised of whether this also holds for the cover that is sought. This does not appear to be consistent with the basic principle that windfalls may not be used for new policy and also raises the question of how this could be reconciled with the fiscal rules of play.

III. The Advisory Division finds that in this Budget Memorandum and corresponding appendixes an attempt has been made to increase transparency of the tax development and that an improvement has been made in this regard. At the same time it establishes that the figures in the Budget Memorandum are difficult to interpret, for example when they are compared with the tax development as presented by the CPB in the Macroeconomic Outlook (MEV) (difference of € 1.5 billion). It recommends to pay attention to the differences in the forecasts in the Budget Memorandum and try to harmonise the different definitions over time that are applied by the Ministry of Finance and the CPB.