Raad van State

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2019 Spring Report on Fiscal Monitoring

1. Introduction

The Advisory Division of the Council of State is responsible for the independent monitoring of compliance with European fiscal rules as meant in the Treaty on Stability, Coordination and Governance (TSCG) and Article 5 of Regulation (EU) 473/2013. The task of the independent fiscal monitoring institute is to assess compliance with the European and national fiscal rules. The Advisory Division works closely with the CPB Netherlands Bureau for Economic Policy Analysis (CPB) in preparing its assessment. Drawing up of independent economic and budgetary projections and analyses is the responsibility of the CPB; the Advisory Division is responsible for an assessment of compliance with European and national fiscal rules.

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

For the sake of quality and accuracy of the assessment to be drawn up, for the Spring Report the Advisory Division is given access to the draft version of the Stability Programme. On the basis of this, the Advisory Division has prepared a draft assessment which has been discussed with government in an *audi alteram partem* procedure. The Advisory Division concludes its final assessment after being informed of the government's response. The government's response is included in full in the report.

This Spring Report is structured as follows. The report starts with the assessment, in this Section A. The analytical part, which is the substantiation of this assessment, is included in Section B. The government's response is included in Section C.[1]

[1] Parts B and C are not included in the English translation.

2. Macroeconomic and budgetary projection

This year, economic growth in the Netherlands is expected to reach 1.5%. The same level of growth is forecast for 2020. This means that the Netherlands slightly differs in a positive sense from developments in the eurozone, for which the forecast growth for 2019 is 1.2% and 1.4% for 2020. The growth expectation for 2019, in comparison to the September 2018 Report, has been adjusted downward by 0.7 percentage points. This is caused by uncertainties in the global economy that lead to reduced export. Producer and consumer confidence is declining. Government spending is increasing, but by taking government underspending into account in this forecast, the effect on growth is somewhat tempered. According to the 2019 Central Economic Plan (CEP), unemployment will stay low at 3.8% (345,000 people). This means the labour market is tight and is expected to only change to a limited degree in 2020.

In 2018, the budget balance was actually 1.5% of GDP.[2] This is due to the fact that not all originally proposed spending took place (underspending), and consistently high tax revenues were due to, albeit adjusted downwards, an ever favourable economic cycle. According to the most recent CPB forecast, the balance remains positive in both 2019 and 2020, at respectively 1.2% and 0.8%. The underlying structural budget balance – the balance adjusted for the state of the economy and incidental items – is also positive (0.8% of GDP in 2018 and 0.6% of GDP in 2019 and 2020).

In 2018, government debt decreased to 52.4% of GDP. The debt ratio is expected to fall below 50% of GDP this year (49.1% of GDP in 2019 and 47.1% in 2020). The downward trend of the debt is a result of the budget surplus in combination with economic growth and inflation (denominator effect).

3. Review under fiscal rules

In the Spring Report the Advisory Division reviews whether public finances of the past year (*ex post*), during the current year (*'in year'*) and in the forthcoming year (*ex ante*) comply with European fiscal rules. Due to the budget balance being compliant with the maximum allowable deficit under the Stability and Growth Pact (SGP) of 3% of GDP since 2013, the rules prevailing under the so-called 'preventive arm' of the SGP are relevant for this review. These rules impose requirements on development of the structural budget balance, which is the budget balance adjusted for the economic cycle and incidental items, and the development of public expenditure. In addition, government debt must be below 60% of GDP, or at any rate, decreasing to a sufficient degree in that direction.

Ex post. Based on actual figures by Statistics Netherlands, the Advisory Division concludes that public finances complied with European fiscal rules in 2018. The actual general government balance shows a surplus of 1.5% of GDP for the whole year 2018. In 2018, the structural budget balance resulted in 0.8% of GDP.

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[2] Actual figures reported 2018 CBS Statline.

This means that the structural budget balance complied generously with the so-called 'medium-term budgetary objective' (MTO) of –0.5% of GDP set for the Netherlands. When the structural budget balance does not exceed the threshold criterion, a review of the European expenditure rule, which is aimed at a controlled growth of public expenditure in relation to the potential growth of the economy, can be omitted in accordance with the working methods of the European Commission. Nonetheless, it can be concluded that Dutch public finances also complied with the expenditure rule in 2018 (refer to Table 3).

In 2018, government debt was 52.4% of GDP, which is below the threshold value of 60% of GDP. Thus, government debt was likewise compliant with European fiscal rules.

'In year' and ex ante. In 2019 and 2020, the actual budget balance is expected to remain positive. Thus the actual budget balance, once again, is compliant with the threshold value of -3% of GDP in the SGP. The structural general government balance shows a reasonably stable picture of 0.7% in 2017, 0.8% in 2018, 0.6% in both 2019 and 2020, which is clearly better than the medium-term budgetary objective of up to -0.5% of GDP.

As the structural government balance in the current forecasts of 2019 and 2020 continue to meet the MTO, a review of the expenditure rule can be omitted in accordance with the working methods of the European Commission. Nevertheless, review of the expenditure rule shows that the anticipated solid growth of expenditure, particularly in 2018, did not materialise. This is due to exceptionally high underspending. The reason for the exception is currently due to the relative extent of underspending occurring in 2018 (1.5% of the budget expenditure, particularly for Defence and Infrastructure), in conjunction with the causes, including the labour market shortage, which will not have disappeared right away in the coming two years. Underspending is therefore also taken into account in the forecasts for 2019 and 2020. It brings about budgetary uncertainty; should the underspending turn out to be lower than currently expected, this will immediately lead to a decrease in the general government balance.

Based on the CPB forecast, the Advisory Division concludes that the Dutch government finances are expected to remain within the limits set by the *European fiscal rules* in 2019 and 2020.

In the first place, *national fiscal rules* specify expenditure ceilings. According to the CEP, expenditure both in 2019 and 2020 will remain below the agreed fiscal ceilings. Again, underspending is expected in both years in all contexts (national government budget, healthcare and social security).

Forecasts are intrinsically surrounded with uncertainties. It is important that these uncertainties are explained properly. The Stability Programme briefly addresses risks. For example, a scenario of reduced world trade by 1% is calculated, but, considering the profusion of international uncertainties, that cannot even be regarded as an astute scenario. This scenario leads to a downward readjustment of growth by 0.5% of GDP in 2019 and 0.6% of GDP in 2020. In this context, it is appropriate that the government respectively addresses downward risks and scenarios in the 2020 Budget Memorandum, as promised for the Advisory Division's recommendations in previous fiscal reports.

4. Trend-based fiscal policy

In previous reports, the Advisory Division called attention to possible procyclical consequences of an expansive fiscal policy. The Advisory Division notes that the multi-year budget with a delayed economic growth path, now turns out less procyclical than previously expected and more in line with the envisaged trend-based fiscal policy.

Trend-based fiscal policy means that in further cyclical economic downturns, sudden budget cuts or austerity measures can be avoided. That is not only sensible economically, but in view of the current state of public finances also leaves room for budgetary manoeuvre within the framework of European fiscal rules.

However, some points for attention apply to this.

a. The position of Dutch public finances may be considered favourable, but in a European context, it is not exceptional. There are at least four EU countries with a higher budget surplus and there are nine countries with a lower debt ratio than the Netherlands. In the European Commission's 2018 Fiscal Sustainability Report, the Netherlands is classified in the ‘overall long-term risk category’ of an EU comparative overview as ‘medium’ when it comes to structural sustainability of public finances.

In other words, the Netherlands is a ‘mid-range’ country.

The European Commission's 2018 Country Report Netherlands identifies concrete measures which, when implemented quickly, benefit domestic demand and potential growth and could bring about a linking up with the top European countries. To this end, the European Commission points out the intentions in the coalition agreement with regard to the housing market, labour market and pensions. The Country Report additionally specifies further reform of the tax system and of education. It goes without saying that the introduction of such reforms can benefit from the use of budgetary latitude. The European Systemic Risk Board further stressed the need, certainly for the Netherlands, not only to reduce general government debt, but also that of private households.

b. All this against the background that, as mentioned above and analysed in more detail in Section B, there are actually only downward risks. It is therefore sensible not to allow the room for budgetary manoeuvre between the level of public finances and the boundaries of European fiscal rules to dissipate too fast.

c. Insofar as such ‘trend-based’ latitude is used in the further cooling down of the economic cycle to mitigate its consequences, the collective tax burden must also be reviewed. The collective tax and social security contributions increases this year from

39.1 in 2018 to 39.6. Since 2015, this has increased by approximately 3pp and is currently relatively high, which can also have a negative impact on consumer confidence.

d. In closing. The Advisory Division thinks it is wise that the underlying methodology and rules are maintained in the trend-based fiscal policy. In this report, an example of accuracy and transparency of the forecast of expenditures on healthcare is included in Section B. In the Advisory Division's opinion, it is recommended to continue to work towards gaining a better and earlier insight into expenditures on health, given the major claim of healthcare costs on collective expenditure and the difficulty in managing its growth.

5. Conclusion

In light of the findings and conclusions, as well as the response from government on the draft assessment (see Section C), the Advisory Division of the Council of State assesses the following.

I. Based on actual figures by Statistics Netherlands, the Advisory Division concludes that public finances complied with European fiscal rules in 2018.

II. Based on projections by the CPB, the Advisory Division concludes that the public finances of the Netherlands are expected to remain within the boundaries of the European and national fiscal rules in 2019 and 2020.

The level of public finances provides latitude to maintain the trend-based fiscal policy, so too in the event of cyclical adversity. It is therefore necessary to monitor (a) the continuous working towards strengthening the economic structure, (b) uncertainties and downward risks, (c) the collective tax burden development, and (d) maintaining the underlying methodology and rules in the trend-based fiscal policy.