Raad van State

No.W06.18.0044/III/B The Hague, 12 April 2018

Spring Report on Fiscal Monitoring 2018

1. Introduction

The Advisory Division of the Council of State has been tasked with the independent monitoring of compliance with (European) fiscal rules as provided for in the Treaty on Stability, Coordination and Governance (TSCG) and Article 5 of Regulation (EU) 473/2013. It is the task of the independent budget supervisory authority to assess compliance with the (European) fiscal rules. The Advisory Division works closely with the Netherlands Bureau for Economic Policy Analysis (CPB) in preparing its assessment. The allocation of tasks entails that the drawing up of independent economic and budgetary forecasts and analyses is assigned to the CPB; the Advisory Division is 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 which it provides an assessment of the forecast 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 to be drawn up, the Advisory Division is given access to the draft version of Stability Programme. On the basis of this, the Advisory Division has prepared a draft assessment which has been discussed with the government in an audi alteram partem procedure. The Advisory Division makes its final assessment after being informed of the government's response. The government's response is included in full in this report.

This Spring Report is structured as follows. The report begins with the assessment in this section A. The analytical part that provides the substantiation of the assessment can be found in part B. The response from the government is found in part C.[1]

2. The macroeconomic and budgetary prospects

Following good growth of 3.2% in 2017, the Dutch economy will continue to grow strongly in this and the next year, according to the most recent CPB forecast. The economic growth forecast for this year is 3.2%, and 2.7% for 2019. These are strong figures, which the Dutch economy has not witnessed for a long time. These growth figures see the Dutch economy performing better than the eurozone as a whole. In particular, developments in the housing market and the government's expansionary budgetary policy explain that the Dutch economy is performing better than the European economy.

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

Dutch economic growth is broadly based. Increasing labour demand, higher disposable incomes, greater consumption and rising investments combine strengths to create a positive dynamic. In 2018, furthermore, government spending will give the economy a substantial extra boost. This boost will be reduced in 2019, which – coupled with declining growth in exports – result in a slight slowdown in economic growth this year.

The continued economic growth means that the Dutch economy is in a phase of strong upturn. This is also reflected in the unemployment figures, which are currently below their equilibrium levels. Whereas in 2017, 4.9% of the workforce was unemployed (438,000 people), in 2018 this is expected to fall to 3.9% (355,000) and in 2019 to 3.5% (320,000 people).

In 2017, the budget balance was 1.1% of GDP. Despite the strong upturn, public finances for 2018 and 2019 show no further signs of improvement. This is down to the expansionary budgetary policy. According to the CPB forecast, the actual budget balance in 2018 and 2019 will be somewhat lower compared with 2017, although a budget surplus of 0.7 and 0.9% on GDP respectively is still expected. Underlying this, there is a worsening of the structural budget balance – the balance adjusted for the economic cycle and one-off measures – from 0.8% GDP in 2017 to –0.4% GDP in 2019.

At 56.7% of GDP, government debt in 2017 fell below 60% of GDP for the first time since 2010. The decrease in debt is the result of the budget surplus and the sale of shares in various financial institutions. The debt ratio is also falling due to strong economic growth and rising inflation (denominator effect). In the years ahead, debt will fall further according to the CPB forecast, to 52.1% of GDP in 2018 and 48.4% of GDP in 2019.

3. Assessment under the fiscal rules

In its Spring Report, the Advisory Division assesses whether public finances in the previous year (*ex post*), in the current year (*'in year'*) and in the year ahead (*ex ante*) comply with the European fiscal rules. As the actual budget deficit is below the maximum deficit of 3% GDP, as permitted under the Stability and Growth Pact (SGP), the rules of the so-called 'preventive arm' of the Pact are relevant in terms of the assessment. These rules impose requirements on the development of the so-called structural government balance (the budget balance corrected for the economic cycle and one-off measures) and for development in public expenditure. Furthermore, Government debt should be below 60% of GDP, or falling sufficiently in that direction.

Based on figures from Statistics Netherlands (CBS), the Division concludes that public finances in 2017 complied with the European fiscal rules. The treasury showed a surplus of 1.1% of GDP for the whole of 2017. In 2017, the structural government balance was 0.8% of GDP. This means that the structural government balance amply met the so-called 'medium-term objective' (MTO) of –0.5% of GDP set for the Netherlands. If the structural government balance is on-target, assessment against the European expenditure rule, which is focused on managed increase in public expenditure in relation to potential growth of the economy, is not required under the European Commission's approach. Nevertheless, it may be concluded that Dutch public finances in 2017 also complied with the expenditure rule. Government debt in 2017 was 56.7% of GDP, which is below the threshold value of 60% of GDP. Government debt was thus in line with the European rules.

The actual budget balance is forecast to remain positive in 2018 and 2019. Consequently, the actual budget balance complies with the SGP threshold value of –3% of GDP. However, the structural budget balance is set to worsen in both years, showing a deficit of 0.4% of GDP in 2019. While this means that the structural government balance (just) continues to meet the medium-term objective set for the Netherlands, the development shows an underlying worsening of Dutch public finances. Furthermore, based on the assumption of further reductions in gas production towards 12 billion cubic metres by 2022 at the latest, at the current price of natural gas, the lower threshold of the structural balance (–0.5% of GDP) comes into view.

Because the structural balance in current forecasts for 2018 and 2019 (just) continues to meet the medium-term objective, the European Commission's approach does not require assessment against the expenditure rule for these years either. However, the expenditure rule demonstrates that the decline in the structural balance can largely be contributed to the strong increase in expenditure in 2018 in particular. Government debt will continue to fall in 2018 and 2019. This means that government debt in both years meets the SGP debt criterion.

Based on the CPB forecast, the Advisory Division concludes that Dutch public finances are forecast to remain within the limits of the European fiscal rules in 2018 and 2019, but that there is an underlying worsening of public finances, which should not be expected in times of economic upturn.

Forecasts for the future are inherently surrounded by uncertainty. It can be derived from the CEP that given the forecast of the actual balance of 0.9% of GDP for 2019, there still is a one-in-three chance of a budget deficit.

In light of the above, the Advisory Division notes that the sensitivity analysis in the Stability Programme 2018 does not consider the reduction in gas production and the effects of this on the structural balance.

Neither does the Stability Programme look at the procyclical nature of the budgetary policy, and little attention is paid to uncertainties and risks and how to address these. Chapter 4 contains only a couple of brief, rather technical alternative scenarios, which are projected only for the short term.

In light of the above, the Advisory Division considers an updated, more integrated risk analysis and discussion of this to be desirable, such as was seen in the Budget Memorandum 2015, for example. The Advisory Division recommends including a more detailed risk analysis in the Budget Memorandum 2019.

4. Development in public expenditure and taxes in greater detail

The Advisory Division notes that a brief look at the public expenditure ratio and total revenue ratio offers only partial insight into the underlying development of government revenue and expenditure. Public expenditure will further increase in the years ahead. This is, however, not reflected in the gross public expenditure ratio, which falls between 2017 and 2018 and remains quite constant thereafter. Underlying this, however, are sometimes substantial increases in public expenditure, in particular in the areas of defence, infrastructure and healthcare.

Neither is the development of government revenue easy to interpret. Despite the announced tax-relief measures, the total revenue ratio will remain virtually constant over the coming years. Therefore, it is more interesting to look at the indicator for the so-called 'policy-induced revenue development'. This indicator reflects the budgetary effect of policy measures on tax and social security revenues. Considered across the whole term of government, there is an overall decrease in taxes of €1.5 billion. Juxtaposed to the lower wage and income tax, there is an increase in VAT, energy taxes and health insurance premiums. The tax-relief measures entirely benefit families; businesses face an increase in taxes taken over the entire term of government.

This demonstrates that figures regarding the development of government revenue are not always easy to interpret. The indicators used do not all give equal insight into the underlying changes. Furthermore, different reports on the development of government revenue sometimes refer to the year-on-year change ('horizontal'), while in other places, for example in the financial appendix to the Coalition Agreement and in the Budget Memorandum, the mutation with regard to an earlier decision-making point in time is referred to ('vertical'). The horizontal development is socially and economically relevant because it provides insight into how families and businesses 'experience' the tax developments from one year to another. However, for parliamentary approval the vertical development is relevant.

The limited transparency which some indicators result in, and the different reports used (vertical vs. horizontal), make discussion about '*the* tax development' complex and susceptible to lack of clarity, however. The Division therefore advises greater clarity in the development of government revenues to the States General.

5. Conclusion

The findings and conclusions, as well as the government response to the draft assessment (see part C), result in the following assessment by the Advisory Division of the Council of State.

I. Based on figures from the Statistics Netherlands (CBS), the Division concludes that public finances in 2017 complied with the European fiscal rules.
II. Based on the CPB forecast, the Advisory Division concludes that Dutch public finances are forecast to remain within the limits of the European fiscal rules in 2018 and 2019, but that there is an underlying worsening of public finances, which should not be expected in times of economic upturn.

III. The Advisory Division considers that an updated, more integrated risk analysis and discussion of this are desirable. The Advisory Division therefore recommends that the Budget Memorandum 2019 should include a more detailed risk analysis of public finances.
IV. Given the complexity of the terms used, and the different reports with respect to development of government revenue, the Advisory Division recommends greater clarity of reporting to the States General.