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Dutch government budget 2019

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On the third Tuesday of September, Budget Day, the government announces its plans for the coming year. At the same time, the CPB presents its Macro Economic Outlook

Macro Economic Outlook (MEO) 2019

- The CPB expects the Dutch economy to continue growing at an above-average rate of 2.8% in 2018 and 2.6% in 2019
- After the downturn in 2018, growth in world trade will pick up again slightly in 2019 and, as a result, Dutch exports will increase faster than in 2018
- Consumer spending and investment will increase more slowly in 2019 than this year
- This year's government spending will rise considerably more slowly than forecast, given that part of the extra boost to spending cannot be implemented until next year
- Inflation will rise sharply in 2019, mainly because of the rise in the lower rate of VAT
- Unemployment will fall slightly further, thanks to the ongoing, albeit slightly less strong growth in job creation

2019 Budget Memorandum

- The government will increase spending and reduce the net burden on households
- Thanks to various additional measures, almost everyone will see an increase in purchasing power next year
- The EMU surplus is set to rise to 1.0% of GDP in 2019, having fallen from 1.2% to 0.8% this year
- Without the favourable effects of the currently strong economic growth, next year's general government balance would be negative. However, the government believes its finances to be sufficiently shock-resistant
- The tax burden on businesses will rise in 2019
- The EMU debt will fall to 49.6% of GDP, compared to 62% in 2016

MEO 2019: Economy to continue growing at above-average rate

As in 2017 and 2018, the CPB (Netherlands Bureau for Economic Policy Analysis) expects the Dutch economy to continue growing in 2019 at a faster rate than average, although growth is set to fall from 2.8% this year to 2.6% in 2019. For both years, this represents a slight slowdown from the forecasts in June this year.

Economic outlook: the Dutch economy is performing well ...
This year, **exports** will rise considerably less fast than last year, owing to the slowdown in growth in world trade. However, the CPB expects this growth to pick up again next year, with the result that Dutch exports will then rise faster than in 2018.

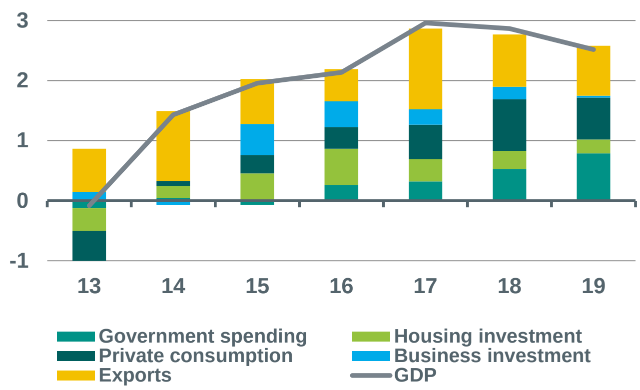
Other areas, too, are contributing to the strong rise in GDP. **Consumer spending** may rise in response to favourable developments on the income front – specifically growth in employment, higher rises in wages and the tax cuts scheduled for 2019, while consumer confidence is also high. However, the slight slowdown in employment growth in 2019 will have a slight impact on growth in consumer spending.

Growth in **corporate investment** will also be slightly lower in 2019 than this year, but will continue to outstrip the rise in GDP. As a result, the investment ratio will increase further. The CPB notes the high capacity utilisation rates, the positive outlook, high profits and low costs of capital. However, as business confidence levels among manufacturers have been falling for a while, the CPB is expecting lower growth in corporate investment in 2019.

While **residential investment** will also continue rising strongly, the growth rate will once again be lower than in the previous financial year (see table next page). The catch-up growth on previous years will be less significant, while the tight labour market is also holding back production in the construction sector.

Broad-bases GDP growth continuing

Spending components' contribution to GDP growth in % points



Source: Based on MEO 2019

Government spending will rise considerably faster this year than last year as a result of the strong boost to spending provided for in the Coalition Agreement. However, the increase will be less than forecast, given that not all the additional spending planned seems able to be implemented this year and so some will be carried over to 2019. As a result, government spending in 2019 will rise by more (rather than less) than in 2018.

Unemployment will continue falling in 2019, to 3.5%. This is slightly lower than was seen at the time of the previous economic boom ten years ago. The fall in unemployment is attributable to the strong increase in job creation, particularly in 2017 and 2018. Now, however, the labour market is tightening, with more and more staff shortages. The CPB consequently expects wages and salaries to rise faster than previously.

Inflation will rise sharply next year. This is mainly because of the increase in the lower rate of VAT, although higher energy taxes will also play a part.

… but risks have increased

While the outlook is favourable, the CPB highlights the increase in downside **risks** for the economy internationally, including the greater likelihood of a trade war and a hard Brexit. Meanwhile economic policy in Italy and the slowdown in growth in various emerging markets, including Turkey, are creating a sense of uncertainty.

Lastly, the CPB points to the domestic risk that not all the planned increases in government spending will be able to be implemented and that this will impact on economic growth.

The growth forecasts published by the CPB are almost identical to those of ABN AMRO.

Key figures for the Dutch economy

	2017	2018	2019
		% change	
GDP	2.9	2.8	2.6
Private consumption	1.9	2.7	2.3
Government spending	1.1	2.0	2.8
Investments	6.1	5.1	4.3
- residential	12.0	8.5	5.9
- businesses	5.5	4.1	3.4
Government	1.1	4.4	5.0
Exports	5.3	3.0	4.2
Imports	4.9	3.3	4.8
Real disposable income	1.0	3.0	2.1
Consumer prices (CPI)	1.4	1.6	2.4
		Levels	
Unemployment (% of working population)	4.9	3.9	3.5

Source: CPB, MEO 2019

2019 Budget: stable surplus means further fall in debt

Following the substantial improvements recorded in 2016 and 2017 the government's EMU surplus will come out slightly lower in 2018 and 2019 than in 2017. This is as a result of various government measures announced, including the additional spending increases and also the net reduction in the burden on households planned for 2019. However, the 2019 surplus will be slightly higher than in 2018.

Implementing the Coalition Agreement

Almost all the measures announced for 2019 derive from the Coalition Agreement of October 2017,[1] when the government agreed a substantial *additional* increase in spending and also a tax reduction for the current legislative period. These changes should be viewed in relation to the 'baseline scenario'; i.e. how patterns would have developed *without* these extra government measures. Under the route mapped out by this baseline scenario, spending was in any event set to rise,[2] while higher compulsory health insurance premiums and various other measures announced by the previous government would have increased the total tax burden.

Under the Coalition Agreement, the extra spending during this legislative period is to be used primarily in the fields of social security, defence and education. Most of the boost to spending was scheduled for 2018 and (to a lesser extent) 2019. However, not all the spending planned for 2018 seems likely to be able to be implemented this year, and some measures will therefore roll over to 2019 (or later).

While the focus of the government's plans for its first few years in office is primarily on additional spending, the total net tax burden will not actually fall until 2020. Households, however, will start seeing the benefits in 2019, partly because of the introduction of a two-bracket structure for income taxes. At the same time, the lower rate of VAT will rise from 6% to 9%, while an additional rise in energy taxes has also been announced. However, the net burden on households will fall slightly.

Wishes for the future

This year's Budget also devotes attention to certain important policy themes for the future, including the climate, the labour market, pensions, the housing market, international relations and the financial markets. While the government is planning further reforms in these fields, it cannot yet provide any details of what exactly these will involve, partly because it is still seeking support from relevant parties in society and also wants to be sure its policies are feasible in practice. At this stage, therefore, the government is able only to indicate the direction of its future policies in these fields.

With regard to the **labour market** the government stated that employment relationships should reflect preferences and the type of work involved. The numbers of self-employed people and staff on flexible contracts in the Netherlands have increased much more than in other European countries. Regulations should be improved so as to prevent unfair competition between permanent employees and those on flexible contracts. The government also considers it important that self-employed people should be able to insure themselves

[1] https://insights.abnamro.nl/en/2017/10/euro-watch-finally-a-new-dutch-government/
[2] An increase in spending is normal. Spending increases in line with growth in the economy or population.

against occupational disability and is consequently in talks with insurance companies on possible ways to improve the available options.

With regard to **pensions**, the government repeated its wish for these arrangements to become more transparent for participants, for the flat-rate contribution system to end, and for people to be allowed the option to draw down part of their pension capital in a single lump sum when they retire.

In the case of the **housing market**, the government recognises the need to build more homes, particularly in the mid-market rental sector. It is seeking to encourage housing associations to build by simplifying the market test they have to carry out when building these sorts of properties. It also plans to reduce the housing shortage by taking steps to combat excesses in the existing housing stock. Municipalities should be given wider-ranging opportunities to deal with undesirable developments in tourist rentals, rack-renters and problematic holiday parks. The tax facilities available to home owners will also be reviewed during 2019, with special attention being paid to the complexity and effectiveness of the current facilities, alongside the costs for home owners, banks and the tax authorities.

With regard to **Europe**, the government made clear its lack of interest in a European solidarity fund to absorb economic shocks, arguing that this would result in countries undertaking fewer efforts to reinforce their own defences for themselves. Private investors should bear the costs of any future losses they incur on government bonds. The government is seeking to prevent its contribution to the EU budget rising as a result of Brexit. In addition, it is making efforts to reach agreement on reallocating expenditure within the EU, with the idea being to give greater priority to security, climate, border controls and innovation. It sees opportunities for reducing spending on agricultural policy and the cohesion policy, while also wanting to invest more in diplomacy and the armed forces in order to increase safety. As well as extra spending on defence, the government is allocating money for more diplomatic representation.

In the case of the **financial sector**, the government is seeking to create a more diverse range of financial service providers, with this extra diversity being designed to promote greater stability. By encouraging new, innovative players to enter the market and lowering the barriers to entry, the government aims to boost competition in the sector. One of the ways it may do this is by introducing a banking licence 'light' for businesses focusing on certain specific services. Later this year it will present its agenda for introducing a list of measures to promote a stable, ethical and innovative financial sector.

Lastly, the government emphasised the importance it attaches to **climate policy**. On 10 July this year a proposal was presented for the National Climate Accord in implementation of the objectives set for 2030 and 2050. The government is also working on a minimum price for CO_2 emissions and plans to introduce a kilometre-based charge for heavy goods vehicles. Businesses that fail to innovate and continue producing high emissions will end up paying more.

Government spending measures for 2019

The government plans to increase spending in 2019 by an extra EUR 8 billion. These additional funds will largely be allocated as follows (x EUR billion):

- education, research and innovation (including more teachers, higher salaries)	1.9
- defence (more personnel and equipment)	1.2
- infrastructure (non-recurring)	1.0
- security (mainly police)	0.5

The government is also taking account of potentially adverse developments. These include the possibility of a hard Brexit and the extra work this would involve for Customs and for the Food and Consumer Product Safety Authority, which would have to comply with more formalities, as well as inspecting goods. Provision has been made for the costs of such extra work.

The contribution to the EU will rise in 2019 by a net EUR 0.3 billion, while the government has also made a provision of EUR 0.5 billion for possibly higher-than-forecast payments to the EU.[3] In addition, the government is having to deal with the consequences of the decision to turn off the Groningen gas tap by 2030 at the latest, as well as the resulting fall in gas revenues. Gas revenues in 2018 will now come out EUR 0.1 billion than foreseen in the Coalition Agreement, while the difference with the original forecast for 2019 is EUR 0.3 billion lower.

The net effect of the above is that the government will be spending more in these areas than previously foreseen. However, it will not need to introduce any compensatory measures to prevent spending rising above the ceiling that has been set. This is because of various favourable developments on the expenditure side, particularly in healthcare and social security, and the fact that the lower interest rates and lower government debt mean lower amounts of interest are payable.

Lower tax burden for households – but not yet for businesses

The Coalition Agreement had already foreseen lower income taxes for households in 2019, partly owing to the plan to phase in a two-bracket structure for income taxes. However, as the government was not satisfied with how purchasing power was likely to develop in 2019, it has now announced a series of additional measures that will mainly benefit lower and mid-range incomes. As a result, almost everyone's purchasing power seems set to rise.

Corporate tax rates are also going to be reduced in phases, with the upper rate being cut by 0.7% points in 2019 and the lower rate by 1% point. However, the deductibility of interest will be limited (this will make it less attractive for businesses to take on debt). The net effect is that revenues from corporate taxes in 2019 will in fact rise.

As it turns out that the tax burden for businesses will reduce by more than was foreseen in the Coalition Agreement (the abolition of dividend tax planned for in 2020 is proving to be more expensive for the government than previously calculated), the government has decided to reduce the amount by which the higher corporate tax rate will be cut during this

[3] These payments rise in line with economic growth. The CBS recently revised the national accounts and calculated a higher GDP. There is now, therefore, a realistic likelihood that the Netherlands will have to make higher payments to the EU.

legislative period. The reduction in the lower rate will, however, go ahead as planned. In this way, the government is aiming to provide some protection for the SME sector, while the tax burden on employment in this sector will also go down.

Budgetary results for 2019

The government's overall surplus for next year is forecast to increase to 1.0% of GDP, following a fall this year to 0.8% (from 1.2% in 2017). On the one hand, the strong economic growth of recent years means a substantial rise in tax revenues and lower spending on unemployment benefits. This will benefit the general government balance, while interest expense is also decreasing. On the other hand, however, the government has announced additional spending, as well as tax cuts (for 2019). The net effect, therefore, is that the surplus will be lower than in 2017.

Key government finance figures

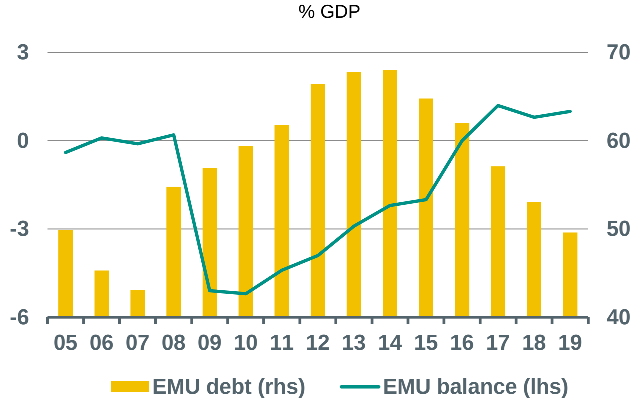
	2017	2018	2019
EMU balance (% GDP)	1.2	0.8	1.0
EMU debt (% GDP)	57.1	53.1	49.6
Total net burden (EUR bn; - = decline)**		-0.2	5.3
- of which companies		0.6	4.4
- of which family households +		-0.5	0.8

** Due to policy measures. + Taxes and social premiums, *excl.* higher allowances

Source: Budget Memorandum 2019 and CPB (tax burden)

The net burden for households will fall slightly in 2019, mainly because of the reduction in direct taxes, while various allowances payable to families will see a slight rise (not included in the above table[4]). On the other hand, however, the lower rate of VAT and the energy taxes will increase. The tax burden for businesses is going to increase substantially, including in the form of higher employer social security contributions, higher energy costs and the increase in VAT.

Debt continues falling thanks to growth and surplus



Source: Budget Memorandum 2019

[4] In 2018 and 2019 these allowances amount to EUR 0.8 and 1.1 billion, respectively.

Thanks to the strong economic growth and the government's overall surplus, which will come out slightly higher in 2019, government debt as a percentage of GDP will continue to fall. In 2019 debt will even fall below 50% of GDP, compared to the 62% recorded in 2016. However, while the EMU surplus is now higher than before the 2008 crisis, debt is still above the level it was at that time (see graph on previous page).

The government's overall surplus is largely attributable to strong economic growth. But if adjusted for the favourable effects of this growth, next year will see a deficit, with the net *structural* balance falling from +0.8% of GDP in 2017 to +0.2% in 2018 and then to -0.4% in 2019 (source: CPB). In other words, government finances are less healthy than they appear.

Lastly

The Budget Memorandum shows what the government plans to spend extra money on next year and what costs for taxpayers are going to go down. On this occasion the government is reversing some of the spending cuts implemented by its predecessors. The Memorandum also outlines the policies the government will be pursuing in its aim to 'improve' the Netherlands' position. However it says little that was not already known, while there is often also a lack of detail on the specific measures to be taken. The amount, for example, that the Climate Accord will (or may) cost us still has to be calculated. Entirely in line with tradition, the government is going to leave it to the '*polder*' to sort out. The question, however, is whether that will always be possible.

As mentioned earlier, the strong economic climate is flattering the government's finances. Without this effect, next year would see a deficit. If, therefore, the economy were to enter more difficult waters, the current surplus could suddenly rapidly become a deficit. While the government itself admits that its finances are strongly moving in tandem with the economic cycle, it nevertheless regards them as sufficiently shock-resistant, based on various stress tests that have been performed.

However, the structural deficit referred to applies not only in respect of 2019, but also for the longer term (the 'sustainability surplus or deficit'). Last year, a calculation of the likely impact of measures in the Coalition Agreement showed that, in the longer term, the government would have a deficit of around 0.4% of GDP because of government spending rising faster than revenues over the longer term. And while this figure of -0.4% of GDP is also repeated in this year's Budget Memorandum, it takes no account yet of lower gas revenues.

The question also arises as to what is going to happen as far as increases in the state retirement age are concerned. While the employer and employee representatives ('the social partners') have proposed that the government should stop further increasing the retirement age for the time being, any such decision would further increase the sustainability deficit. In view of the currently favourable economic climate and the availability of some 'lubrication oil' to smooth things out, it should surely be possible now to reach agreement on pensions. That will be a lot more difficult in a more challenging economic environment.

Lastly, a few comments on the plans to abolish dividend tax. Irrespective of whether or not this is good for the Dutch economy, the new governing coalition (or perhaps, to be more precise, the Prime Minister, Mark Rutte) should have sensed that taking such a step would not go down well. Everyone wants to share in the stronger economy. The labour income share has been under pressure for years, while people are increasingly less willing to allow businesses, particularly large multinationals, to reap all the benefits. There are just so many other things we want money to be spent on, including education, the police, healthcare and our purchasing power.

Find out more about Group Economics at: **https://insights.abnamro.nl/en/category/economy/**

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