Dutch delivering on Draghi’s demands?

ECB President Mario Draghi called upon governments with fiscal space, most notably Germany and the Netherlands, to fiscally “act in an effective and timely manner” and urged all eurozone members to “achieve a more growth-friendly composition of public finances”. Did the Dutch government deliver in its 2020 budget?

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Disapproval toward Frankfurt’s policies

During last week’s Governing Council press conference, Mario Draghi left the ECB with a big monetary bang. In the Netherlands, this was received as controversial. In anticipation of this big bang, the majority of the Dutch House of Representatives signalled its disapproval of further monetary stimulus, and even went so far as to send a formal letter to the ECB. Fearing the negative effect of an even lower interest rate on the coverage ratio of Dutch pension funds, it shared its concerns about the tiering of the deposit rates; providing comfort to banks without equally comforting funded pensions didn’t seem right to Dutch parliamentarians.

All the same Draghi called for Dutch fiscal expansion

Additionally, the Dutch member on the Governing Council of the European Central Bank, Klaas Knot, commented that “[t]his broad package of measures, in particular restarting the APP (Asset

Purchase Programme), is disproportionate to the present economic conditions". Knot also voiced concerns about the effectiveness of the measures. The ECB president nevertheless responded that it is a good time for the Dutch government to activate a supposed 50 billion euros investment programme. Despite domestic annoyance towards further expansionary monetary policy, did the Dutch government deliver on Draghi's wishes in its 2020 budget?

No big bang for Draghi's goodbye

The Dutch government presented its budget for 2020 on 17 September and King Willem-Alexander delivered his thrones speech. While the thrones speech emphasised the EU as a cornerstone of Dutch foreign policy, the Dutch did not give Draghi a mind-blowing farewell present. The budget contained no concrete proposals for an investment fund and certainly no €50 billion (which would have been the equivalent of 6% of Dutch GDP) boost to investment.

A small farewell present nevertheless

What the new budget did bring was a small present in the shape of a mildly more expansionary fiscal stance. The medium-term coalition agreement already had expansionary aims. The previous forecasts had foreseen fiscal stimulus of 0.3% GDP, but with the new policy initiatives, the Dutch will be delivering even more in 2020. With the structural budget balance deteriorating from a positive 0.3% GDP in 2019 to -0.4% GDP in 2020, the fiscal discretionary fiscal expansion amounts to 0.7% GDP (€6 billion).

Highlights from the 2017 Dutch coalition agreement

More tax relief for households, less for corporates in 2020

Most of the fiscal expansion is due to the reduction in labour income taxation, aimed at boosting the purchasing power of households. This was already part of the medium-term plans for the year 2021, which the government is now carrying forward to 2020. Apart from the deterioration of the government budget balance, this will mainly be financed by higher energy taxes from businesses and a delay in the lowering of corporate tax rates. Where the government initially intended to lower total taxes on households by €1.5 billion in 2020 and by €1.9 billion for businesses, the new budget includes €4.4 billion of tax relief for households and only €0.2 billion relief for businesses.

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Upset by the perceived "low" wage growth delivered by businesses so far, the government deliberately shifted some money from businesses to households and added relief to households on top. This is in line with the more critical attitude towards businesses of late. This, however, does not mean a serious deterioration of the business and investment climate of the Netherlands: corporate tax rate cuts, which were initially announced in the coalition agreement for 2020 will be still be delivered in 2021.

[Dutch Economy Chart Book, with graphs on Dutch public finances]

More humble investment fund on its way

Furthermore, Draghi's hopes for an investment fund were not entirely in vain. The budget memorandum promised to deliver a report to Parliament at the start of 2020 about the possibilities of such a fund, while Minister of Finance Wopke Hoekstra emphasised that the fund is not a matter of "yes or no" but rather of "how and when". The government referred to the low-interest rate and low productivity growth as reasons for a fund aimed at strengthening the growth potential of the Dutch economy in 20 to 30 years. However, it is unclear what the size of the investment fund would be. For now, the Minister of Finance is signalling that the fund could be worth "several tens of billions", not necessarily reaching the level of €50 billion as mentioned earlier. And the minister stressed that the funds wouldn't get all the money in one go, but rather gradually, when a flow of viable projects have been identified.

Signs of serious intentions

While we have to wait for the details of the fund, in the meantime the Minister of Economic Affairs & Climate will deliver a letter to parliament with a more general "agenda for growth" by the end of 2019, with options for policies (both financial and non-financial) that may boost potential growth, including options for boosting public as well as private investment. This shows that the intention to boost the country's growth potential are real and ideas for concrete investment projects may already be in the making.

One small step for Europe, one giant leap for the Netherlands

What does this all mean? The worsening of the structural budget balance next year and plans for a humble investment fund may seem like a small step, but it's a giant leap for the Dutch.

In order to provide the additional tax relief, the Dutch government had to violate its own long-standing national fiscal rules that dictate medium-term spending limits. Such violations are very uncommon. This comes on top of the fact that the current government had already started its reign with looser fiscal rules than its numerous austerity-minded predecessors, by excluding a number of cyclical components outside its medium-term spending ceiling that allows for more Keynesian automatic stabilisation.

We believe it's fair to say that the Netherlands is doing more of what Draghi and others like him are asking for. A well-designed investment fund would enhance prospects for the business climate in the Netherlands, which might be a reasonable attempt to combat low productivity growth observed across the OECD. And so it appears that the Netherlands remains an important European partner in the quest for economic growth.

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