Political uncertainty in the Netherlands to slow greening of the economy

The Dutch government collapsed on Friday after being in power for just 18 months. Today, PM Mark Rutte announced he will leave politics. New elections will probably take place in November. Within many large political parties, the leadership is now up for grabs, implying high uncertainty. Here, we look at the economic impact over the shorter and medium term

Dutch Prime Minister Mark Rutte has resigned after the government coalition collapsed following failed consultations on asylum policy

Policy will be at a standstill for a long time

The collapse of the government means that the adoption of required legislation and the implementation of intended controversial policies – policies that coalition parties and other parties within parliament have had difficulty agreeing on - will go on hold. Parliament will have to return from its summer break on 27 July to vote on the topics it considers controversial (*note that after the initial publication of this article, Parliament decided to hold the vote in September*). Besides migration, topics that come to mind include sustainability (including combatting and mitigating climate change and nitrogen-emission), the housing market and perhaps labour market policies and tax reforms (including wealth taxes and child and rental allowances).

Policies that are considered less controversial and have already started to be implemented, such as pension reform, may continue, although it would not be unusual to halt legislative progress on such topics at a later stage. Ministers and state secretaries of the coalition government will initially stay in office as a caretaker government to lead the execution of non-controversial policies. Given the lack of clarity in the political landscape (VVD, D66, CDA, PvdA/GL, CU – 63% of current seats – might all have new political leaders), we would not be surprised to see relatively few policies being labelled as such. The caretaker government will have to continue until a new government has been formed. Last time, negotiations took 299 days. With elections taking place in November, we would not be surprised to see a new government coming to power somewhere in the third quarter of 2024.

2024 budget should be easier to agree on than for 2023

One of the first challenges is the budget for 2024. On the third day of September, the government presents the budget for the next year. It is customary to tweak tax and allowance policies that affect household purchasing power. This should be less difficult than last year, when measures to combat the energy crisis had to be agreed upon, as inflation is expected to come down and is likely to be surpassed by wage increases in the near future. The government has already signalled that the energy support measures will mostly stop by the end of 2023 and that such policies will likely continue at a much smaller scale and in a much more targeted fashion than in 2022-2023. It seems likely that the caretaker government will be able to get a majority for some continuation of support for lower-income households in 2024.

Continued nitrogen emissions to hamper other sectors

More important than the short-term impact is the potential longer-term impact. This impact comes via the lack of change in the Dutch economy. Two important fields are related to sustainability: the (agricultural) change required to limit nitrogen emissions in order to protect and restore the environment (facilitated by a fund for cumulative expenditures of about €24bn, 2.5% of annual GDP) and policies for limiting carbon emissions. Lack of progress in the former will slow down the transition in agriculture, but also hamper economic activity in other sectors such as renewable energy, carbon storage and the construction of homes, infrastructure, and commercial buildings. As there are local emission limits, especially close to environmentally-protected Natura-2000 areas, continued nitrogen emissions in agriculture will continue to hamper other sectors, for example, construction projects will not be approved.

Carbon emission policies could look different

Uncertainty about carbon emission policies leads to uncertainty about carbon-intensive sectors. The recent approach of the coalition has been to set very ambitious climate targets while aiming to keep energy-intensive industries mostly in the Netherlands. For this, it was using subsidies (‘maatwerkafspraken’) to allow these companies to be able to compete internationally. In total, the coalition had proposed a €34bn (3% of annual GDP) climate fund to fund 120 measures aimed at lowering the carbon intensity of existing activities. The first question for corporates will be whether the next government will be as ambitious on climate goals, the second will be whether it will still want to keep the same industries in the Netherlands and the third will be whether the government would be willing to do this via compensation and other ‘carrots’, or would use more ‘sticks’ like norms and taxes. And if it does, will it build on the current initiatives or propose new plans? This will slow investment (and thus the economy), while also slowing the energy transition.

As a consequence, reaching the carbon emission targets in the medium term will become nearly impossible.

Investors in housing construction might hope for change

Another important field is the housing market. The current coalition had decided to limit rental prices and discourage private investment in rental homes while trying to make new construction attractive via subsidies. The pace of new construction is currently under pressure, as overall this hits the attractiveness of new development in the short term. The price adjustment in the housing and market for (undeveloped) land may slow down as a consequence of the coalition's break up, as professional players may hope for a new government to make a U-turn and end their disinvestment in the Dutch housing market. New construction, however, is unlikely to speed up in the short run, as the uncertainty for investors remains high.

Continued dual labour market, pressure on labour migration

In the labour market, the government was developing proposals to tighten the rules for self-employed people and flexible labour. This, for example, includes limitations on flexible employed labour, such as zero-hour contracts, temporary contracts, and mandatory disability insurance for the self-employed. While consultations could continue and a large majority could be in favour of the proposals, the implementation will likely slow down. This way the dual labour market, which currently has a very flexible part and a very inflexible part, will continue to evolve further towards the greater use of flexible labour, making any future change increasingly difficult.

Labour migration has been part of the discussions between coalition parties on limiting overall migration, as it makes up a large chunk of the total inflow. It is likely that limiting labour migration will remain part of the discussion in the upcoming elections, as the inflow of migrants appears to be seen as an issue across the political spectrum. Given the tight labour market, this may hamper growth for corporates that depend on foreign workers.

Tax and allowance system not simplified and wealth tax reform also uncertain

The reform of the tax and allowance system which was aimed at simplifying a complex system, including initiatives to revise the rental and child care allowance, might be halted. Specifically, the change in wealth taxation (from a flat rate to taxing actual returns) will slow down, and may not happen at all given its political sensitivity. The latter would keep the current incentives for real estate investment in place, as the direction of intended new policies was expected to be more detrimental.

Growth even more meagre in 2024

The caretaker government will likely lower government spending versus the planned expenditure on climate policies, agriculture and housing, for example. This will have a dampening effect on the economy. This effect will be mild, however, as the labour market is currently overheated. Any additional government spending was therefore likely to lead to a crowding out of jobs in the private sector. From an employer's perspective, the breakup may thus free up some workers who are in high demand. Simultaneously, the political uncertainty will slow some corporate investment. As a result, we could see marginally higher unemployment. The situation is, however, unlikely to change radically, given that firms are expected to hoard labour even in a scenario with weaker demand, given their long experience with labour market strains and ongoing ageing. The output gap is and will remain positive in the very short run, meaning that shortages of personnel will remain one of the major issues faced by Dutch businesses. GDP growth, which was already expected to be soft, will turn out to be even more meagre at the end of 2023 and at the start of 2024. A technical recession in the first half of 2023 is likely to be followed by several quarters of GDP growth which could be described as "stagnating". This means that the economy will become a little bit less overheated, while wage and price pressures might be alleviated somewhat.

Public finances improve a little while short term debt projections were already low

Public finance indicators might improve a little, as some expenditures are halted, leading to lower net debt issuance. As the public debt ratio hovers around 50% of GDP, there are also no immediate worries about public finances and therefore possible effects on the yields on Dutch government bonds should be limited.

Financial abundance no silver bullet for trade-offs in a fragmented political landscape

All in all, the impact on the cyclical state of the economy will be to marginally slow it down. We would expect this to be easily manageable for the overheated Dutch economy. Important transitions, such as the greening of the economy, however, will seriously slow down. The only upside being that from an economic perspective, the coalition had decided to use an inefficiently high level of subsidies to allow for political support. And at least there is a theoretical possibility that the next government, experiencing the effects of higher interest rates, may use 'sticks' a bit more. The more important lesson, however, is about the difficulty of complicated transitions in times of political fragmentation. The political risks of painful trade-offs often are too much to take. If the luxury of nearly (perceived) unlimited budgets proves insufficient to help these transitions, the question is whether a new government will be able to make many potentially painful trade-offs using sticks. The vote is out on that.

Author

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com