Estimates confirm break with frugality in new Dutch coalition agreement

A first quantitative analysis by the independent Netherlands Bureau of Economic Policy (CPB) of the economic effects of the recent Dutch coalition agreement confirms that policies are clearly expansionary and could contribute to an overheating of the Dutch economy in the short term, strongly at the expense of public finances

Worsening of public finances in the short run

On the date of its release (15 December 2021), we concluded that the new Dutch coalition agreement implied a farewell to the usual Dutch fiscal frugality. This is clearly confirmed by analysis from the Netherlands Bureau of Economic Policy (CPB), which quantifies the macro-economic effects of the policies that have been sufficiently spelled out. Their analysis shows that the gross public debt ratio will deteriorate to 56.1% GDP in 2025 (the year of the next general elections), compared to 54.0% GDP in the no-policy-change baseline. The projected headline government budget balance is estimated to increase from -0.7% of GDP to -2.7% of GDP in 2025. This is a substantial loosening of fiscal policy in the short run, almost completely driven by higher expenditures, and in contrast to the traditional Dutch tendency towards prudence.

See here for our initial take on the coalition agreement of the Rutte IV government

Fiscal stance also very loose in the long run

Many plans have similarly large implications beyond the government's term of 2022-2025. While the coalition seems to be aiming at a structural balance of -1.75% of GDP, the structural balance is projected by the CPB at -3.1% of GDP in 2025, compared to -0.8% of GDP in the no-policy-change baseline. The fiscal sustainability balance will be reduced by 2.7% GDP to -4.3% of GDP. Based on the current interest rate term structure, debt will be in the range of 47-65 percentage points of GDP higher in the long run (2060) than in the base case, with the potential to go beyond 90% of GDP. This shows that the fiscal stance is extremely loose, especially for the longer term. Historically, this is remarkable. Not since the introduction of the CPB's quantitative analyses of coalition agreements has there been a Dutch coalition agreement with such a large net expenditure increase. In particular, expenditures on education, social security, combatting climate change, the environment and defence are structurally higher.

Admittedly, there could be potential benefits for future generations, such as a higher education level, higher productivity and a healthier environment. These, however, have not all been estimated, and they need to be large to outweigh the high net expenditures. The policy package decreases income inequality, as suggested by the estimated decrease in the Gini-coefficient. This comes at the expense of structural employment, which is estimated to be 0.5% lower.

https://think.ing.com/snaps/new-dutch-coalition-agreement-is-farewell-to-frugality/

Policies likely to contribute substantially to overheating

The analysis also shows that the policies are likely to be very expansionary. While one could argue that the fiscal impulse is too large for regular macro-economic models to handle, especially in times of an already very tight labour market, the CPB estimates the average effect on annual GDP growth to be 0.5 percentage points in 2022-2025 with the average annual effect on the HICP-inflation rate at 0.2 percentage points. If the model outcomes are taken as a given, the policy package will reduce the unemployment rate in 2025 by 0.8%. From a business cycle perspective, the economy does not really need this impulse, as the unemployment rate came in at a record low 2.7% in November 2021, with inflation expectations around 3% for 2022. While a new lockdown is currently reducing economic activity temporarily, insufficient demand does not appear to be one of the major concerns for the Dutch economy: Dutch GDP was already 1.8% above its pre-crisis peak in the third quarter of 2021.

Plenty of homework left

Insufficiently specified or implausible policies, such as (health care) austerity measures without the necessary conditions, are either fully or partially excluded from the analysis by the CPB. Temporary expenditures (especially for combatting climate change) beyond the government's term which address problems that are structural in nature are assumed to be structural. All this means that the new government, which was sworn in 10 January, still has some homework to further specify how exactly it wants to reach its (structural) goals.

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