New Dutch coalition agreement is farewell to frugality

A new coalition agreement in the Netherlands has been published after the longest negotiation process ever for the country. Climate change, environment protection, housing, education, childcare and lower taxation are the economic priorities. With larger public deficits, we're seeing a change to the traditionally frugal Dutch stance

Mark Rutte is expected to be confirmed as Prime Minister making him one of Europe's longest-serving leaders

The Dutch have a new coalition agreement ending a stalemate that's lasted for 273 days since elections in March; such a long negotiation is a record for the country. It consists of the same four ruling parties, liberal conservatives VVD, Christian democrats CDA, centrist liberal democrats D66 and the Christian-social party ChristenUnie (CU). Parliament will debate this week and is expected to approve the appointment of Mark Rutte as “formateur”; he'd be responsible for building a ministerial team.

We expect a new government to be formed in the second week of January and it would mark Rutte's fourth term as prime minister. Political journalists suggest that talks on the division of jobs among parties have already started and that there will be an increase in the number of ministers and State Secretaries, from 24 to 29. The ministerial team will be backed up by a majority in the Second Chamber (House of Representatives), but the coalition parties still hold a minority of seats in the First Chamber (Senate).

Greener, higher educated, more generous and simpler

Combatting climate change, protecting the environment, speeding up the construction of housing, boosting education and labour market participation and simplifying the tax system are some of the major (shifts in) economic priorities. Outside the economic domain, one of the major themes of the agreement is the strengthening of democratic checks and balances. Fiscally, the agreement does not look as frugal as we are used to.

More detail on the economic ambitions

▪ On **green issues**, ambitions are raised, in both words (-55% carbon emissions by 2030) and funding. The coalition intends to create a fund for combatting climate change (i.e. reducing carbon emissions, cumulatively 4.3% of annual GDP) and a fund for a "national programme in rural areas", probably mostly aimed at reducing nitrogen emissions (including buyouts for farmers near protected nature areas, cumulatively 3.1% of annual GDP).

▪ The coalition will boost **education** (+0.5% GDP spending). It wants to turn the temporary additional efforts of the National Programme for Education, which was meant to reduce Covid-related educational deficiencies, permanent. It also opts for an increase in the salary of primary school teachers to those in secondary school. Also, the system of funding individuals' education will be overhauled to rely more on subsidies than loans (+0.1% GDP).

▪ The "**child care allowance affair**" – which eventually meant the downfall of the previous government - now leads to a simplification of the tax (allowance) system, which also implies that the coalition will make child care almost free for working parents (95% will be funded directly rather than via the parents, costing 0.3% GDP).

▪ The government will boost investment in **housing construction**, not least by making additional funds available (cumulatively 0.9% of annual GDP for housing-related infrastructure). The importance of this priority is underlined by the introduction of a new ministerial position of Housing and Spatial Planning and the abolition of the social housing corporation tax (+0,2% GDP).

Some other notable changes are:

▪ Additional spending on **defence** to reach the EU-NATO average level (+0.4% GDP, to 1.85% GDP);

▪ Apart from more spending on pandemic-readiness, **healthcare** is the only significant reduction in structural spending (-0.6% GDP);

▪ Preparations for the construction of two new **nuclear** power plants;

▪ 7.5% higher **minimum wage;**

▪ A long term plan for taxation and road user charges for both electric and fuelled cars. This is not expected before 2030.

Public finances: farewell to frugality

In a hurry to publish the coalition agreement before the parliamentary Christmas recess and in light of the fact that the agreement deliberately seems less detailed and specific than previous ones, the coalition decided not to wait for scrutiny of its plans by the independent Netherlands Bureau of Economic Policy (CPB), which is rather unusual. This means that an elaborate analysis of the economic effects of the plans is not et available, including an independent estimate of the public finances. Expectations are that this analysis will be published later.

This is a break from the past

Relying on the coalition's numbers we will see labour taxes (mostly on labour, +0.5% GDP) and higher spending, especially in the short-run (net +2.4% GDP on average in 2022-2025). Over the course of the next couple of years, we may see deficits of around 2.5% GDP. Once the one-offs are taken out, the coalition is striving for an average government deficit of 1.75% GDP. This is a break from the past. Temporary higher spending only means a one-off for public debt and as a result has relatively little impact on long term fiscal sustainability. This seems to have become a politically acceptable way to boost spending, illustrated by the creation of several temporary funds. The change in stance seems to be related more to longer-term objectives than to the state of the business cycle in the Dutch economy. The unemployment rate is very low at 2.9%, so we may well see some overheating in the next couple of years.

For the Dutch government, the intended spending spree is a shift away from the traditional frugality, as was already expected based on party manifestos for the 2021 elections. However, the coalition strives to stabilise the debt-to-GDP ratio at around 60% and that keeps Dutch government finances still in safe territory. Not only will this lead to short term growth, but the plans may also help long term potential economic prospects. Higher structural spending on education, in particular, should translate into more beneficial productivity development, while cheaper child care and lower labour taxes might boost the labour supply.

On the Stability and Growth Pact, the agreement is rather vague: it is open for modernisation of the agreement, as long as it is aimed at 'fiscal sustainability and economic convergence'. The traditional Dutch focus on effective enforcement of rules remains.

See here our Three calls for the Dutch economy in 2022 for the outlook on short term economic developments.

Author

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