

Stability Programme of the Netherlands
2003 - 2008

December 2005 Update

Chapter 1 Introduction and summary

Strengthening the economic structure is the main policy focus in this Cabinet term. This Cabinet's policy is aimed at restoring economic drive and competitiveness by boosting labour participation and productivity growth and maintaining sustainable wage levels. The Cabinet's reform agenda comprises measures to foster employment and labour participation, reinforce the knowledge economy, facilitate mobility and structurally improve public finances. The government is set to implement most of its structural reforms in the year 2006.

In 2004 the Dutch economy cautiously emerged from the trough with a growth of 1.7%. A slowdown in growth is projected for 2005. The economy is expected to pick up in 2006, however, at a rate which – for the first time in five years – exceeds potential growth, finally bringing the Dutch economy well out of the doldrums.

Thanks to Cabinet policy, public finances are showing visible improvement throughout the Cabinet term. Sound public finances are vital to sustainable economic growth. In recent years the Netherlands has succeeded rather well in consolidating public finances, despite significant unexpected economic setbacks. Within three years after the Cabinet took office, the structural deficit has been narrowed by around 1.5% of GDP. The structural deficit in 2006 is expected to be 0.7% of GDP, so that the Netherlands will respect its medium-term objective (MTO): a structural deficit of between 0.5% and 1.0% of GDP, in line with European agreements arising from the revised Stability and Growth Pact. In 2007 and 2008 the structural deficit will stabilise at 0.7% of GDP, respecting the MTO for these years too. The quality of public finances has improved, i.e. the share of spending in structure-enhancing areas, such as education and infrastructure, has increased over the past decade.

The marked improvement in public finances during this Cabinet term does not yet mean that the sustainability of public finances should be taken for granted. Policymakers will have sharper insight into the impact of demographic ageing on the sustainability of public finances early next year when the National Bureau for Economic Policy Analysis (*Centraal Planbureau/CPB*) presents new ageing projections. The near-term priority is to find the right balance, in accordance with the prevailing budgetary system, between budgetary consolidation on the one hand, and the evolution of spending and taxes for households and enterprises on the other.

This stability programme was submitted later than usual. The Netherlands made this choice in order to give the truest possible picture of its financial and economic situation. During the budget deliberations in October, the Cabinet left scope for supplementary policy in December depending on developments in households' purchasing power, linked notably to movements in oil prices. In early December, the Netherlands Bureau for Economic Policy Analysis released new data on expected purchasing power and also presented its new insights into economic developments. Based on these data, the Cabinet decided there was no necessity to implement an extra policy

measure to repair purchasing power. The Cabinet did decide on some specific measures but these have no effect on the picture presented below.

For an analysis of the sustainability of public finances, which must be submitted annually under the new Code of Conduct, the Dutch government depends on the projections by the EPC working group on ageing population. The Code of Conduct also requires that the common projections be incorporated in the stability programme update. This update uses the data available up to mid-December and otherwise relies on (provisional) calculations by the CPB.

Chapter 2 Economic outlook

Introduction and summary

The Dutch economy has come through a rough patch. Following robust growth of 3.7% a year on average in the second half of the 1990s, economic growth slid back sharply in 2001. The Dutch economy even stagnated in the years 2002 and 2003, suffering under high wages, rising pension contributions, falling equity prices and euro appreciation.

With growth at 1.7%, the Dutch economy climbed cautiously out of the trough in 2004. A slowdown in growth is projected for 2005, owing to more sluggish growth in relevant world trade, high oil prices and the delay in fully restoring price competitiveness. Domestic demand is also lagging behind in 2005. The economy is expected to pick up in 2006. For the first time in five years, the expected growth rate exceeds potential growth, finally bringing the Dutch economy well out of the doldrums.

The acceleration in growth in 2006 will be driven by both a pick-up in domestic demand and an increase in exports. Relative to the year before, enterprises are expected to invest just $\frac{1}{4}\%$ more this year but $8\frac{1}{4}\%$ more next year. The increase in investment in 2006 will be supported by rising corporate profits. Having postponed investment in recent years, enterprises will feel compelled to start investing. They still had some respite in 2005 owing to the decline in the capacity utilisation rate. Producer confidence also showed a sharp increase. At +3.0 in November 2005, the producer confidence index is back to approximately the level seen in February 2001.

Besides the pick-up in investment in 2006, private consumption is expected to show cautious growth of 1% (adjusted for the introduction of new health care system). Household income will rise thanks to an increase in real wages ($\frac{1}{2}\%$ year-on-year), employment growth, release of employee savings, reimbursement of overpaid disability contributions and tax cuts. The speeding-up of growth in the global economy and expanding growth in the euro area, an important export market, will push the Dutch economy in the right direction in 2006.

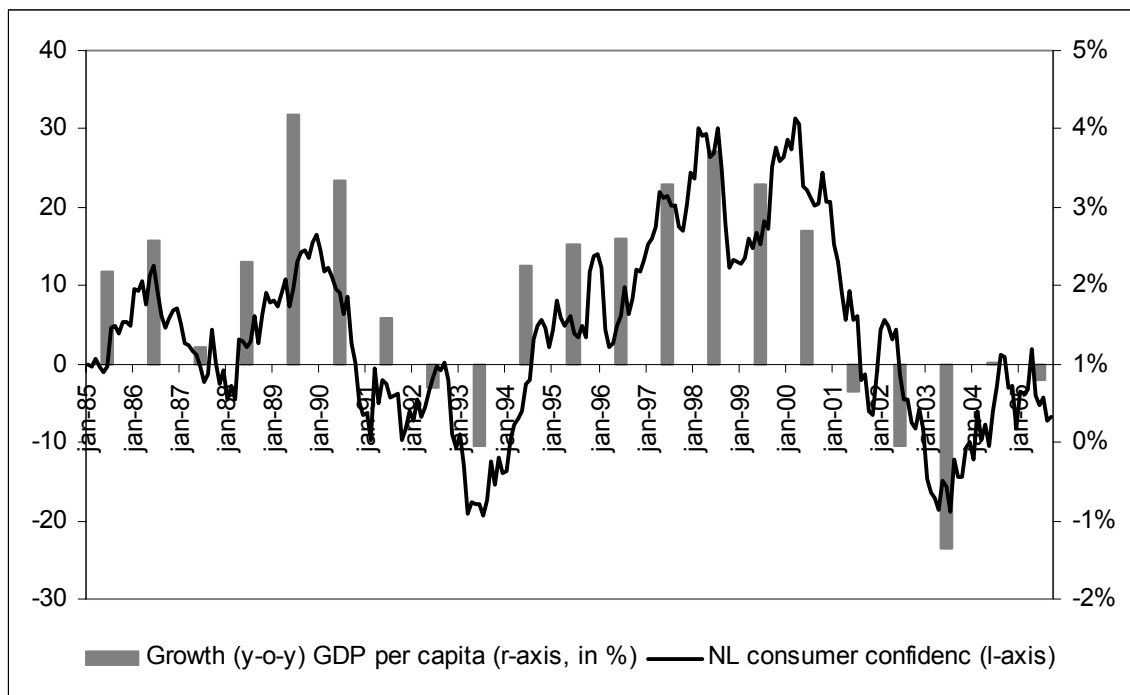
Most uncertainties relate to international developments – in oil prices, long term interest rates and exchange rates. Chapter 4 looks at the financial and economic consequences for the Netherlands should these risks materialise. In addition, for a smaller open economy like the Netherlands, competitiveness is of the utmost importance. Sustainable wage levels and higher productivity growth are vital if the Dutch economy is to benefit from a worldwide economic upswing. Any favourable development in house prices would boost the economy.

Consumer confidence and structural reforms

The strength and duration of the recent economic downturn revealed weak spots in the Dutch economy which threatened long-term potential growth. This called for structural changes in the working of the Dutch economy.

However, introducing structural reforms during economic bad times presented the government with a tricky dilemma. When this Cabinet came into power, consumer confidence was low, notably because of the marked economic downturn. In the short term, structural reforms – besides their direct impact on households' disposable income – can have negative effects resulting from greater uncertainty, a higher savings rate and lower consumer spending. This generates the risk of further restraining economic development. However, the Cabinet was convinced that postponing the necessary reforms was not an option. That would only have added to the uncertainty. Closer analysis of consumer confidence confirms this picture. The figure below shows consumer confidence and welfare growth (GDP per capita).

Figure 2.1 Consumer confidence and welfare growth



Source: European Commission, AMECO

Consumer confidence had indeed sunk to an historical low at the outset of the Cabinet term. However, there are no indications that the policy of structural reforms has further tempered consumer confidence. Two developments suggest that the structural reform policy had a moderate effect on cyclical developments.

Firstly, consumer confidence improved rather soon after the Cabinet took office. Consumer confidence was at its lowest ebb in the second quarter of 2003. The new Cabinet came to power in June, at that point in time the reform agenda was announced. In the long term, this Cabinet's reforms will enhance Dutch households' welfare. The anticipation of greater prosperity could make consumers feel more confident.¹ So the Cabinet policy of structural reforms could well boost consumer confidence.

¹ Annex II deals more closely with the correlation between welfare developments and consumer confidence

Secondly, it is questionable whether negative consumer sentiment actually induced changes in consumer behaviour. Uncertainty should be reflected in larger savings. Data show the opposite to be true, however: consumers actually dissaved in 2003 and 2004. Between 2001 and 2004 the savings rate fell from 2% to -2%.

All in all, the dissaving and the development in consumer confidence do not suggest that the Cabinet policy of structural reforms has exacerbated the weak economic conditions by lowering confidence. The short-term loss of growth was hence not too serious, whereas long-term economic prospects have improved.

Price competitiveness, labour costs and the balance of trade

Over the past five years, Dutch manufacturers' price competitiveness was substantially eroded by more than 11 percentage points. During that period, the Dutch economy seems to have been hit by an almost perfect storm, seriously undermining its competitiveness: high labour costs, rising pension contributions, falling equity prices and euro appreciation. Wages had soared in the preceding period during the euphoria of the second half of the 1990s. But when global economic growth lost momentum and equity prices collapsed, the Netherlands was faced with a fall-off in output while employment was slow to adjust. Productivity declined, causing unit labour costs to climb up.

Despite the slowdown in economic growth, employment measured in persons expanded in 2001 by almost twice the historical average. Actual unemployment remained below equilibrium unemployment, since enterprises were still building up labour reserves. Consequently, there was little downward pressure on wages (see Box 2.2 on inflation persistence). In the period 2002 – 2004, negotiated wages rose by one percentage point more than consumer prices. Negotiated wages hence stayed at high levels. In tandem with the economic downturn, equity prices collapsed. The plunge in equity prices in 2000 and the low level of contributions in previous years (when 'pension premium holidays' were a common occurrence) meant that pension funds had to raise their contributions in the following years to maintain an adequate funding ratio for their members. Finally, the euro exchange rate against the dollar rose from 0.90 dollar per euro in 2001 to 1.24 dollar per euro in 2004. For the Netherlands, the effective appreciation of the exchange amounted to 16.2% between 2001 and 2004, or 5.1% annually.

In 2005 and 2006, unit labour costs will improve relative to the Netherlands' competitors. Unit labour costs in manufacturing are expected to fall by ¼% in 2005 and 2¼% in 2006. Growth in compensation per employee in the market sector will decline to 1¾% in 2005 and 1% in 2006. This results from a sustainable rise in negotiated wages and the downward impact of some structural adjustments on wage drift. Employment measured in working years is expected to remain stable in 2005. The labour market recovery will not take a firm hold until 2006, when employment will rise by 1%.

Table 2.1 Netherlands labour costs and competitiveness

	2002	2003	2004	2005	2006
Negotiated wages, market sector	3.5	2.7	1.5	1	1½
Compensation per employee, market sector	5.5	4.3	3.5	1¾	1
Unit labour costs	2.6	2.3	-1.6	-¼	-2¼
NL competitiveness †	-4.3	-7.8	-2.5	1	3¼
Net exports (% BBP)	6.5	7.0	7.3	7½	7¼
Contribution of exports to GDP growth (percentage point of growth) †	0.4	0.3	1.2	½	1¼
Employment/population ratio*	74.5	73.6	73.1	-	-

1) Development of unit labour costs in the Netherlands relative to competitors Source: CPB memorandum

"Geactualiseerd koopkrachtbeeld" † CPB Macroeconomic Outlook 2006 and * OECD Employment Outlook 2005

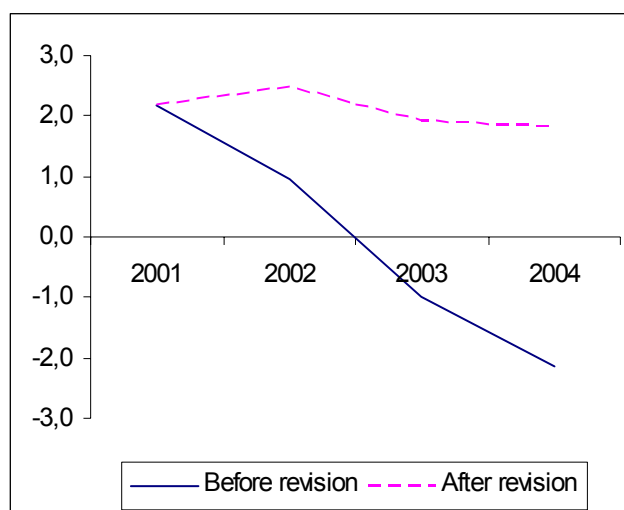
Box 2.1 CBS revision of National Accounts: consumption

Statistics Netherlands (*Centraal Bureau voor de Statistiek/CBS*) periodically makes regular adjustments to the National Accounts. Once every five years, the CBS also carries out conceptual adjustments. In 2005, new international obligations and agreements within the EU caused the CBS to revise the National Accounts over the years 2001-2004. This revision led to conceptual adjustments, the two main ones being changes in the estimation and registration of financial services (Financial intermediation services indirectly measured/FISIM) and the introduction of Special Financial Institutions (SFIs).

The revision raised the level of GDP and influenced the pattern of economic growth over the past years. It led to a significant upward revision

of consumer spending by households over the years 2001- 2004 (see table below). The primary conceptual adjustment to private consumption is the registration of financial services (FISIM). Part of the services provided by banks is now allocated to the users, including households.

Individual savings rate (in % disposable income)



Source: CPB, MEV 2006 en CEP 2005

Consumer spending by households (including non-profit institutions serving households) and household income

	2001		2002		2003		2004	
	bln. euro	in % GDP	bln. euro	in % GDP	bln. euro	in % GDP	bln. euro	in % GDP
Consumption before revision	212.8	49.6%	221.3	49.7%	224.3	49.4%		
Consumption after revision	224.2	50.1%	233.0	50.1%	236.5	49.7%	239.2	48.9%
Change in consumption	+11.5		+11.8		+12.3			
Net disposable income after revision	230.1		235.5		234.0		233.6	

Source: CBS, *Revision of National Accounts: 2001-2004 adjustments*

In 2001, consumer spending increased by EUR 11.5 billion more than previously projected. This upward revision can largely be attributed to improved retail sector data (regular adjustment). The new data for the retail sector show a higher level of turnover than hitherto incorporated in the National Accounts, resulting in an upward revision of EUR 5 billion in 2001. In the same year, the conceptual adjustment led to an upward revision of EUR 5.2 billion. The scale of this revision decreases in the years 2002 and 2003.

The upward revision of consumption supports the picture that consumers, anticipating better times to come, reduced their savings to avoid excessive fluctuations in consumer spending. Judging by the previous CBS figures, the decline in real disposable income appeared to be fully reflected in consumption. That picture now needs to be revised.

Labour market reforms

This stability programme, and that of last year, referred to 'the fallacy of the Dutch miracle'². Dutch labour costs are still too slow to adjust to changes in the output gap. Empirical studies³ point to a connection between the matching of labour costs to cyclical conditions and labour market institutions. Labour supply in the Netherlands improved via two approaches: firstly, measures to enlarge labour supply and secondly, measures to make the labour market more flexible. Chapter 6 deals with the labour market reforms in more depth. Thanks to the labour market reforms, the Dutch economy will be quicker to adapt in future and is better prepared for demographic ageing. Swift wage adjustments to suit changing circumstances are also reflected in

² In its recent country report the OECD also notes that wages are slow to react to cyclical developments and refers to the high 'sacrifice ratio'. According to the sacrifice ratio, the output gap in the Netherlands would have to widen by 7 to 8 percentage points in order to reduce inflation by 1 percentage point.

³ See, for example, European Economy Special Report 1/2005 and Holden and Wulfsberg (2005), "Downward nominal wage rigidity in the OECD", Mimeo, Document presented at the SOLE/EALE World Conference 2005, <http://folk.uio.no/sholden/#wp>

quicker adjustments to consumer prices. Box 3.1 shows that, although there is still room for improvement, the Netherlands' performance within the euro area is relatively strong.

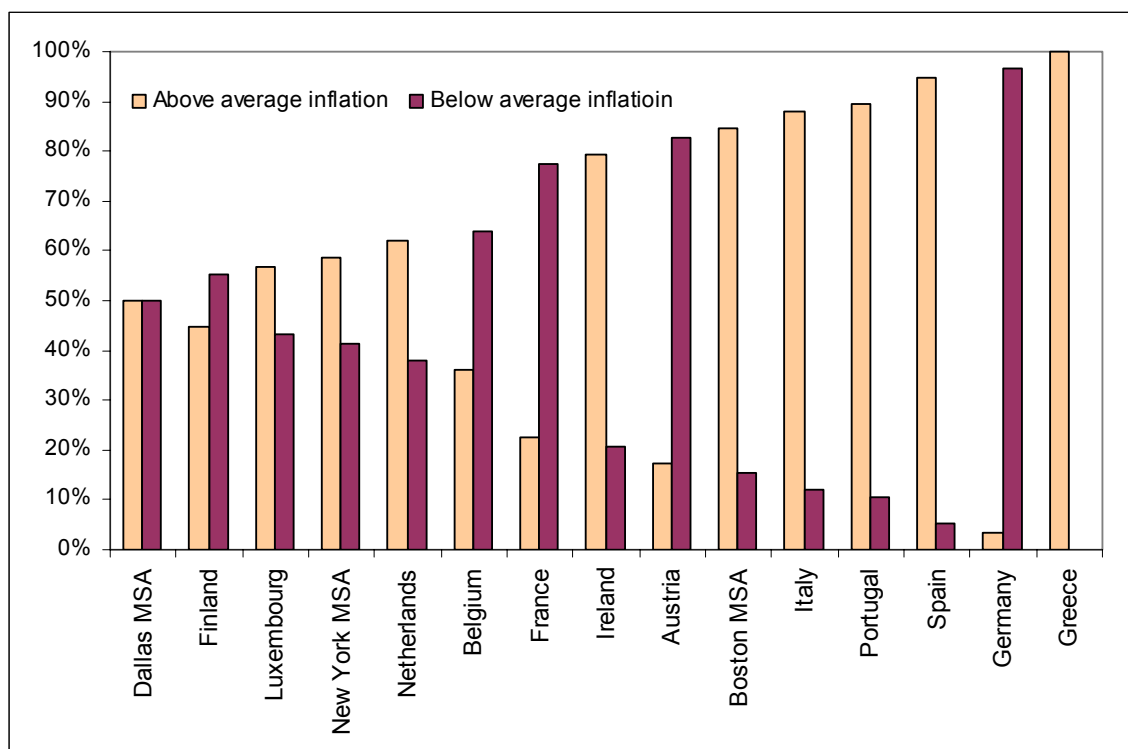
Box 2.2 Inflation persistence

If inflation in member states persistently deviates from the euro area average, there may be structural weaknesses in those economies. Where there is price stickiness, external shocks will notably result in volume adjustments. Price adjustments are generally quicker and less painful than volume adjustments. Inflation persistence within the euro area has drawn increasing attention in recent years (including from the ESCB).

Downward price rigidity is of particular concern. During an economic downturn, wages are not flexible enough, meaning that inflation remains too high and competitiveness begins to erode, (often) coupled with a fall in productivity growth. The chart below shows the frequency with which national inflation in euro area countries is above or below the euro area average. Differences between the number of occurrences of above- or below-average inflation are an indication of inflation persistence. In addition, the same frequency is shown for three metropolitan statistical areas (MSAs) in the US. The MSAs shown are those with the narrowest difference between above- and below-average inflation (Dallas), one which is regarded as representative for the average difference (New York) and one with the largest recorded difference between above- and below-average inflation (Boston).

Looking at the situation outlined above, the Netherlands seems to be doing rather well. There are two countries in the euro area with better scores: Luxembourg and Finland. The Netherlands lags the US, however. Note that this picture does not include the latest inflation developments, which show that inflation in the Netherlands is below the euro area average.

Figure Inflation persistence 1991 - 2005



Source: Author's own calculations based on Bureau of Labor Statistics and Eurostat

Comparison with the European Commission's Autumn Forecast

The European Commission expects economic growth of 0.5% in 2005 and 2.0% in 2006, a less optimistic forecast than that of the Dutch government, which expects growth of ¾% in 2005 and 2½ % in 2006. The main reason for this difference appears to lie in the different projections for oil prices in 2006: the CPB projects an oil price of USD 55 per barrel (Brent), whereas the European Commission assumes a price of over USD 60 per barrel Brent.

Moreover, the CPB is more optimistic as to the development of domestic demand. In the Dutch projections, private consumption is supported by the improvement in purchasing power. On the investment side, notably optimism on investment in housing has shown an increase.

With regard to the general government balance too, the Dutch government is more positive than the European Commission. The next chapter will explain the differences touched on here.

Variable	Source	2004	2005	2006	2007
Economic growth	EC	1.7	0.5	2.0	2.4
	NL/CPB	1.7	$\frac{3}{4}$	$2\frac{1}{2}$	-
Private consumption	EC	0.0	-0.2	-3.0	1.8
	NL/CPB	0.0	$\frac{1}{4}$	-2 (+ $1\frac{1}{4}$) [*]	-
Private investment	EC	2.9	1.4	4.5	6.3
	NL/CPB	2.9	$1\frac{3}{4}$	$6\frac{1}{2}$	-
General government balance	EC	-2.1	-1.8	-1.9	-1.5
	NL/CPB	-2.1	-1.2	-1.5	-1.2

* The figure in brackets has been adjusted for the shift from private to government consumption arising from the overhaul of the health care system.

Chapter 3 Public finances

The past few years were turbulent ones for public finances. Following the budget surplus achieved in 2000, the general government balance was hit by the economic slowdown and showed a sudden and unexpectedly sharp deterioration. Despite an extensive package of measures at the outset of this Cabinet term, the 3% ceiling was exceeded, necessitating more supplementary measures. The balance has since been moving in the right direction, allowing for the (partial) return to trend-based fiscal policy. The picture of Dutch public finances is virtually⁴ undistorted by one-off measures.

Policy strategy

An important objective for this Cabinet is to realise sustainable public finances in the medium term in order to absorb the costs of demographic ageing. At the start of its term, this Cabinet was faced with a new fiscal outlook, showing that the development of the general government balance lagged behind the sustainable path projected at that time. The Cabinet consequently decided to make a timely intervention with a relatively large package of measures of around EUR 12½ billion. It appears safe to assume that this package somewhat strengthened the economic downturn in the short term. In a bid to safeguard economic growth where possible, the package mainly comprised cutbacks in spending, thus curtailing its adverse impact on the economic climate. An extrapolation by the CPB puts the estimated fall in growth resulting from these agreements at 0.2% during this Cabinet term. Having fitted in these measure at the start of this Cabinet period, the Cabinet pursued trend-based fiscal policy thereafter⁵.

However, shortly after the Cabinet took office, the general government deficit widened to such an extent that it endangered the built-in buffer that should keep it under the 3% ceiling (see Chapter 7). Following its own budgetary rules, the Cabinet responded by taking supplementary measures in 2004. The package amounted to EUR 4½ billion and was split more or less evenly between austerity measures and tax increases. Nonetheless, because more setbacks occurred at a later stage (at local government and other levels), this package of measures could not prevent breaches of the reference value (2.5% of GDP) and even the 3% ceiling contained in the Maastricht Treaty.

In response to the breach of the 3% ceiling, the Ecofin Council of 2 June 2004 instructed the Netherlands, in line with article 104.7 of the Treaty, to present measures within four months that would bring the deficit below 3%. The 2005 budget hence contains supplementary measures totalling ½% of GDP, creating the situation that expenditure in the previous budget was structurally around EUR 1 billion below expenditure ceilings, and EUR 2 billion more tax increases were imposed than projected in tax burden targets. Owing in large part to the supplementary measures, the general government deficit in 2004 once again fell below the 3%

⁴ See Koen and Van Den Noord (2005), "Fiscal Gimmickry in Europe: one-off measures and creative accounting", Economic Departments Working paper no 417

⁵ See Chapter 7 for a more detailed treatment.

ceiling. And thanks to the simultaneous occurrence of some favourable fiscal developments, the deficit eventually worked out at 2.1%.

Recent developments

As the deficit was once again sufficiently below 3% (that is to say, below the reference value of 2.5% GDP), the Cabinet could return to trend-based fiscal policy in the 2006 budget (see chapter 7). Expenditure once again returned to the level of the expenditure ceilings. The available leeway was used for investment in areas such as health care, education, security. The Cabinet also took measures in August to support purchasing power, such as scrapping tuition fees and increasing child care subsidies to stimulate labour supply. In addition, some EUR 1 billion was returned in tax cuts, partly because the development of purchasing power was less favourable than previously projected. After submission of the budget, the Cabinet decided on additional tax cuts of EUR 0.9 billion, mainly to benefit households. Net tax burden changes are still above target by EUR 0.5 billion (taking account of the EUR 0.2 billion in tax cuts already envisaged for 2007).

The Cabinet also gave an impetus of EUR 2.3 billion to investment, notably in infrastructure and education via the fund to strengthen the economic structure, (*Fonds Economische Structuurversterking* /FES). The FES is a separate fund that falls outside the expenditure ceilings and draws mainly on gas revenues. The key principle of the FES is that assets underground should be transformed into assets above the ground.

The projected local government deficit is expected to reach 0.3% of GDP in 2006, half of what it was in 2003. The deficit came unexpectedly in 2003, because the local governments had been running small surpluses for many years. In reaction to the unexpected deficit, an executive accord was made in September 2004 with local government representative agencies (see Chapter 7). The parties involved in the executive accord will cooperate in monitoring whether the local government deficit in 2006 stays under 0.5% of GDP.

Tax revenues were boosted by considerable windfalls this year. A box in last year's update dealt with the uncertainties and the importance of a prudent estimation of tax revenues. Box 3.1 once again looks at the projected tax revenues in the light of the recent revenue windfalls. Notably thanks to windfalls on the revenue side, the general government balance over 2005 is expected to work out 0.6% of GDP more favourably than projected at the time of the Budget Memorandum. The Cabinet assumes that 0.2% of GDP of tax revenues is one-off, and can be attributed to higher interest received on tax refunds (see Box 3.1). The effects of the windfalls on the balance for the coming years are based on estimates by the CPB for 2006.

The table below summarises the development in the balance and the successive packages of measures.

Table General government balances, policy packages and windfalls/setbacks (% GDP)

	2003	2004	2005	2006
Coalition agreement (June-03)	-1.6	-1.7	-1.2	-0.8
<i>Windfalls(+)/Setbacks(-)</i>	-0.7	-0.9	-0.9	-0.5
<i>Budget Memorandum (BM)</i> <i>Supplementary policy package 2004</i>	0	+0.3	+0.4	+0.4
BM 2004 (sep-03)	-2.3	-2.3	-1.6	-0.9
<i>Windfalls(+)/Setbacks(-)*</i>	-0.9	-1.2	-1.5	-1.5
<i>Supplementary policy package BM</i> <i>2005</i>	0	+0.5	+0.5	+0.4
BM 2005 (sep-04)	-3.2	-3.0	-2.6	-2.1
<i>Windfalls(+)/Setbacks(-)</i>	0	+0.9	+0.8	+0.5
<i>BM Supplementary policy package</i> <i>2006</i>	0	0	0	-0.2
Macroeconomic Outlook 2006 (Sept.-05)	-3.2	-2.1	-1.8	-1.7
<i>Windfalls(+)/Setbacks(-)</i>	0	0	+0.6	+0.2
December 2005	-3.2	-2.1	-1.2	-1.5

* Including the so-termed autumn agreement between government and social partners

Box 3.1 Uncertainty regarding tax projections

Overall revenue elasticity shows the extent to which the nominal income from taxes and premiums increases in line with the growth of nominal GDP. The overall revenue elasticity is equivalent to the endogenous⁶ increase in taxes and contributions for each per cent of growth in nominal GDP. Where the endogenous increase in taxes and contributions is equivalent to nominal GDP growth, revenue elasticity is 1. Averaged out over a large number of years, revenue elasticity generally has this value. In the short term, however, revenue elasticity may show marked fluctuations.

During an economic slowdown, revenue elasticity generally has a low value owing to so-termed composition effects. There is often a shift from heavily-taxed to lightly-taxed consumption, tempering VAT revenue. In contrast, revenue elasticity often has a high value during an economic boom. Tax projections are hence always surrounded by a high margin of uncertainty, underlining the need for cautious projections.

Based on current insights into the actual figures up to October, projected receipts have been revised upwards by EUR 2.3 billion. Notably corporation tax and payroll tax receipts exceeded expectations. In the case of corporation tax it emerged that, further to an increase in the interest

⁶ Endogenous development is defined as total development excluding policy effects.

received on tax refunds as of 1-1-2005, enterprises (particularly in the financial sector) found it advantageous to initially pay high corporation tax assessments, enabling them to receive the surplus with (above-market) interest later. The interest on overpaid tax has since been lowered by 1.5% to discourage this conduct.

Medium term

The coalition agreement contains a projected path for the balance, showing that the actual general government balance in 2007 would be a deficit of 0.5%. According to CPB calculations at the time, a surplus of more than 1% of GDP would be needed to absorb the costs of population ageing. Adjusted for temporary factors (cyclical conditions and pension contributions, see Budget Memorandum 2004), this corresponded to an actual deficit of 0.5% in 2007. So far, the balance is lagging this projected path, partly because of the persistence of the negative output gap. In the coming period, an economic upturn will need to be put towards enhancing the balance.

Let it be noted that the deficit of 0.5% of GDP given in the outline coalition agreement was not a budgetary target in itself, but rather a result of efforts to return public finances to a sustainable path. Many factors may influence the results of ageing projections, including the weaker performance over the past four years, the impact of structural reforms, the CBS revision of the National Accounts and a number of projection specifications (such as interest rates). The CPB's update of its ageing projections, due for release within a few months, will provide closer insight into the sustainability of public finances.

Cyclically-adjusted budget balance

The cyclically-adjusted budget balance is one of the indicators for the sustainability of public finances during the economic cycle. The development of the structural balance in line with the requirements of the Stability and Growth Pact is one of the two conditions for automatic stabilisation on the revenue side of the budget. Between 2003 and 2006 the structural balance - taking account of a delayed impact of the economic cycle on income and expenditure - will improve by an average of 0.5 percentage point, notably reflecting the significant narrowing of the actual deficit. For the first time since the start of the Cabinet period, this stability programme shows an improvement in the structural balances for the years 2004 to 2007 relative to previous updates.

The table below presents an overview of the period 2003 – 2008. The figures for 2005 and 2006 are derived from the CPB projections of early December. In spring 2006 the Cabinet will present new figures for the development of the balance in 2006 and 2007. The projections for the 2007 and 2008 balances are hence of a technical nature; they are based on an economic growth of 2½% in 2007 and 2¼% in 2008 and revenue elasticity of 1 in both years. Another assumption is that as of 1-1-2007, oil will be priced at USD 26 per barrel and the euro exchange rate will be USD 1.20.

% GDP	2003	2004	2005 ⁷	2006	2007	2008
General government balance	-3.2	-2.1	-1.2	-1.5	-1.2	-1.1
Structural balance Dec-05*	-2.2	-1.3	0.1	-0.7	-0.7	-0.7
Structural balance Dec-05* with lag	-2.6	-1.2	-0.1	-0.5	-0.6	-0.7

* The changes implemented in the autumn forecasts 2005 have been incorporated in this table.

The main change was in the number of hours worked.

The above table also contains a structural balance in which lags have been factored in. In recalculating budget elasticities, the OECD also introduced lags, partly at the EPC's request. These lags are expedient from two points of view: tax-related (i.e. loss set-off) and economic (delayed effect of expenditure and revenues on business cycle).

Medium-term budgetary objective

The Stability and Growth Pact obliges Member States to adhere to the medium-term objective (MTO) for their budgetary positions of close to balance or in surplus. Pursuant to Council Regulation 1055/2005, the MTO for individual member states may diverge from this requirement on the basis of their debt ratio and long-term potential growth. Since the Netherlands' debt ratio is less than 60%, and long-term potential growth for the Netherlands, according to the EPC's calculations, is just above European Union average, the European agreements imply that the Netherlands' MTO ranges between -0.5% and -1%. According to calculations by the European Commission, a structural deficit of 1% preserves an appropriate safety margin for the Netherlands with respect to the 3% ceiling. As shown in the table, the value for the structural balance (excluding one-off measures) for the entire period 2005 - 2008 respects the Dutch MTO, as derived from the European agreements, of -0.5% to -1%.

Debt levels and debt development

The general government gross debt will still increase in 2005 but will stabilise in 2006 at just over 54% of GDP. Projections for 2008 show a decline to around 53% of GDP. The debt ratio will thus remain clearly below the European reference value of 60 per cent throughout the Cabinet term. Measured in euro, the projections show an annual increase in debt. Debt redemption – to reduce interest payments and create scope in the budget to absorb the costs of ageing – is not yet achieved. Revenue from sales of government holdings will be used to redeem government debt.

⁷ In 2005 there was a positive one-off effect on the actual balance of around 0.2% of GDP arising from banking at the Treasury by corporate taxpayers, because the interest received on tax refunds was higher than the market rate. The interest received on tax refunds was adjusted at end-2005, leading to a reverse effect in 2006. See Box 3.1.

Table Development of general government gross debt (in % GDP)*

	2003	2004	2005	2006
1. General government gross debt	52.6	53.1	54.4	54.5
2. Effect of general government balance on debt ratio	+3.2	+2.1	+1.2	+1.5
3. Denominator effect (GDP)	-1.3	-1.4	-0.4	-1.8
4. General government balance and GDP effect (4=2+3)	+1.8	+0.7	+0.8	-0.3
5. Financial transactions and other items	-0.6	-0.1	+0.6	+0.4
6. Total change in debt ratio	+1.3	+0.6	+1.3	+0.1

* Figures may not add up due to rounding.

Chapter 4 Sensitivity analysis and comparison with previous update

Comparison with November 2004 update

Last year's Stability Programme was drawn up against a background of negative growth in 2003 and signs of cautiously expanding growth in 2004. The outlook was reasonably favourable, although the signs were not unequivocal. Today, prospects are much better and signs are more robust that growth is picking up. The outlook for the general government balance has also improved materially.

In September 2005, the CBS revised the National Accounts for the period 2001–2004. This revision consisted partly of the regular processing of additional information and partly of the inclusion of new European rules, of which the allocation of the interest rate margin to private consumption is the most important (see also the Box in Chapter 2). Following the revision, economic contraction in 2003 is now limited to 0.1% year-on-year, whereas 0.9% contraction had been reckoned with earlier. As a result, the transfers to the EU have been adjusted upwards retroactively (by about EUR 0.5 billion). The Table below compares the current Stability Programme with last year's.

Table 4.1 Comparison of November 2004 Stability Programme and current update

	ESA Code	2004	2005	2006	2007	2008
Real GDP growth (%)						
Previous update		1¼	1½	2½	2½	-
Current update		1.7	¾	2½	2½	2¼
Difference		½	-¾	0	0	-
Net lending (% of GDP)	EDP B.9					
Previous update		-3.0	-2.6	-2.1	-1.9	-
Current update		-2.1	-1.2	-1.5	-1.2	-1.1
Difference		+0.9	+1.4	+0.5	+0.3	-
Gross debt (% of GDP)						
Previous update		56.3	58.1	58.6	58.3	-
Current update		53,1	54,4	54,5	53,9	53,1
Difference		-3.2	-3.7	-4.1	-4.4	-

Following a number of successive updates with deteriorating figures, in combination with the necessary policy measures, this Stability Programme is showing improvements on nearly all fronts. For the recent past and the near future, the picture has improved on last year where economic growth, the general government balance and the general government debt are concerned. Only growth for 2005 remains slightly disappointing vis-à-vis last year's forecasts.

Future uncertainties and sensitivity analysis: oil prices

As was the case last year, oil prices again pose a major risk. The risk of higher oil prices, identified in 2004, materialised in 2005. The oil market proved so dynamic that the scenario underlying the Budget already seemed obsolete at the time of publication. In its Budget, the Cabinet assumed an average oil price of USD 52 per barrel for this year and USD 50 for 2006. The external assumptions supplied by the European Commission are based on an average oil price of USD 55 in 2005 and USD 61.4 in 2006. In its latest estimations, the CPB, the main supplier of data for Cabinet estimations, incidentally reckons with an oil price of USD 55 for both 2005 and 2006.

In line with the developments in the CPB's latest published medium-term scenario, allowance is made for an oil price of USD 26 and a euro/dollar rate of 1.20 for 2007 and 2008.

The Dutch economy's sensitivity to oil shocks has decreased materially over the past thirty years. Since the oil crisis of the early 1970s, oil consumption per output unit has dropped by over half. This is not to say that the Dutch economy would not be affected at all by an oil price rise, however. In its Macroeconomic Outlook, the CPB has calculated the effects of an oil price which is USD 15 per barrel higher in 2006. Incidentally, this version reckons with an average oil price of USD 57 in 2005. In early December, the average oil price over the first eleven months of 2005 topped USD 55 per barrel Brent.

Table 4.2 Effects of a higher oil price

	<i>Cumulative divergences, %</i>	
	2005	2006
Gross Domestic Product (GDP)	-0.1	-0.6
Private consumption	-0.1	-0.7
Corporate investment	-0.4	-3.0
Goods exports	-0.2	-0.7
Employment	0.0	-0.3
Consumer price index (CPI)	0.1	0.8
Negotiated wage rate market sector	0.0	-0.3
General government balance (level, % of GDP)	0.0	0.0

The consequent lower economic growth and higher unemployment cause budgetary setbacks. These are, however, compensated for by a substantial increase in non-tax revenues from natural gas. The price of natural gas is linked to the oil price with a lag. Combined, these effects mean that a higher oil price barely affects the general government balance (provided that extra gas revenues flowing to the FES are not spent on investment projects in the same year).

Future uncertainties and sensitivity analysis: interest rates

Long-term interest rates are historically low. The central projection in this year's autumn forecast puts the long-term interest rate in Germany at 3½% in 2005 and 4% in 2006. In the European Commission's external assumptions, the lowest rate in the euro area is 3.3% in 2005 and 3.4% in 2006. Although several causes (savings glut, low inflation, risk aversion, hedge funds) are forwarded, the low level of long-term rates is not explained entirely conclusively. This means that long-term rates could go up. The Table below shows the effects of an interest rate rise in the spring of 2006.

Table 4.3 Effects of higher long-term rates (½ pp in 2006 and 1 pp in 2007)

	Cumulative divergences, %	
	2006	2007
Gross Domestic Product (GDP)	-0.4	-1.5
Private consumption	-0.4	-1.3
Corporate investment	-1.2	-4.6
Goods exports (excl. energy)	-0.7	-2.2
Employment	0.0	-0.4
Consumer price index (CPI)	-0.1	-0.3
Negotiated wage rate market sector	-0.3	-0.7
General government balance (level, % of GDP)	-0.2	-0.8

Source: Central Economic Plan 2005, original scenario based on an interest rate rise in the spring of 2005.

Future uncertainties and sensitivity analysis: the exchange rate

There is no forecasting exchange rates (see Meese and Rogoff, 1984). The wisest course is to assume a random path where the current exchange rate is the best projection of the future exchange rate. The expected dollar/euro rate is therefore not far from the exchange rate prevailing when the economic forecast underlying the Budget was determined. The central projection assumes a dollar/euro rate of 1.20 in 2006. This rate deviates little from the external assumptions of the European Commission which assume a rate of 1.21 in 2006. But totally different future developments are also conceivable. Given the US' formidable current account deficit, the risk of a marked depreciation of the dollar has not yet evaporated. The Table below shows what would happen if the euro were to appreciate by 10%.

Table 4.4 Effective permanent appreciation of the euro by 10% in 2006 en 2007

	Cumulative divergences, %	
	2006	2007
Gross Domestic Product (GDP)	-0.9	-0.9
Private consumption	-0.1	-0.1
Corporate investment	-1.9	-3.4
Goods exports	-2.0	-1.8
Employment (1000 man-years)	-16	-31
Consumer price index (CPI)	-0.6	-1.5
Negotiated wage rate market sector	-0.3	-1.9
General government balance (% of GDP, end-of-period)	-0.1	-0.2

Source: DNB, MORKMON III timetables.

Chapter 5 Quality of public finances

The Cabinet continues to focus on the efficacy and efficiency of public spending. Throughout Europe, the composition and size of public finances are being given increasing attention. Relatively strongly rising expenditure on social security and health care, partly in connection with demographic ageing, may put pressure on policy aimed at reinforcing the economic structure⁸. Of all government expenditure categories, the infrastructure and education normally provide the most favourable conditions for economic growth. Obviously allowance must be made for efficiency, efficacy and the tax implications of expenditures.

As expenditures on the infrastructure and safety grew more than GDP, as well as more than total government spending, in the period 1995-2003, the share of these expenditures in GDP and total government spending has gone up. In recent years, spending on education has also expanded relatively markedly. As in the other EU Member States, Dutch expenditure on health care grew comparatively rapidly in the years 1995-2003, while spending on social security went down.

Change 1995-2003 (% of GDP)	Netherlands	EU-15
Δ Total government expenditure	-7.4	-3.1
Δ Safety	+0.4	+0.1
Δ Social security	-2.1	+0.1
Δ Education	+0.1	+0.2
Δ Health care	+0.8	+0.5
Δ Economic affairs (incl. infrastructure)	+0.7	-1.0

Source: Eurostat.

In its supplementary decision-making in the spring and summer of 2005, the Cabinet sought to strike a balance between structural reinforcement of the economy and support for purchasing power. It decided that the Netherlands will boost the economic structure to an amount of EUR 2.3 billion (0,46% of GDP). Nearly half that amount (EUR 1.1 billion) is to be spent on knowledge, innovation and education. Investment in human capital and innovation are in line with the quest for a high-grade knowledge economy. The environment will be given an impulse of EUR 0.7 billion for measures such as the introduction of carbon filters to improve air quality and the development and application of bio fuels, hydrogen fuels and nuclear fusion. An extra investment of EUR 0.2 billion is made in mobility and spatial planning. The remaining EUR 0.3 billion is spent on monuments and price compensation.

Next to the impulse given to strengthening the economic structure, the Cabinet wishes to make child care more accessible. The costs of this measure total EUR 200 million. More accessible child care will be conducive to a higher participation rate for women, in particular. In addition,

⁸ Public Finance Report 2004, European Commission

tuition fees for 16- and 17-year-olds have been permanently abolished. Finally, expenditure on safety has been permanently raised by EUR 0.2 billion.

The scope created for the economy is explicitly based not just on higher structure-enhancing expenditure, but also on a lower tax burden. As from 2006, the Cabinet intends to lower the rate for corporation tax to 29.6% (2004: 34.5%). Effective 1 January 2007, it will be reduced further, to 26.9%. Moreover, capital tax is abolished as from 2006. These measures form part of the “*Werken aan Winst*” (Towards Greater Profitability) package which the Cabinet plans to realise over the next two years in order to boost (foreign) investment in the Netherlands. Incidentally, these measures will be cost-neutral for businesses because the tax base is simultaneously widened. This mix of lower rates and a wider tax base provides a better foundation for investment and economic growth. Households, on the other hand, will see their burden structurally lowered by EUR 3 billion as from 2006. Indirectly, through consumer spending, this lower burden will benefit the business sector, too.

Reduction of red tape

Compact and efficient government contributes to economic growth, employment and a stronger competitive position. The Cabinet wishes to give entrepreneurs maximum scope to realise their plans, by improving entrepreneurial conditions: among other things, fewer, but more effective rules and less red tape.

A figure-based approach to the administrative burden is a necessary but insufficient precondition for structurally visible results for entrepreneurs. Reduction potential and progress show up more discernibly with the aid of a reference point.

The Cabinet's administrative burden operation is well on course. Its objectives are ambitious (to reduce the burden by a quarter in 2007). Hundreds of rules are being changed or scrapped. By end-2005, a net reduction of over EUR 1.6 billion will have been realised. The remaining EUR 2.5 billion will follow in 2006 and 2007. In the long term, the CPB expects the measures to generate 1.9% GDP growth⁹.

The Cabinet is gearing the operation more closely to the burden and irritations *experienced* by entrepreneurs. For instance, by charting them in so-termed Model businesses and adjusting the package of reduction measures accordingly. Intensification of the package of measures includes the simplification of permits and reducing the supervisory burden for businesses in collaboration with the Cooperating State Inspections (*Samenwerkende Rijksinspecties*).

In order to keep the regulatory and administrative burden to a minimum, the Cabinet plans to adopt new EU legislation and rules integrally, without adding a national component (no gold plating). This measure will take effect retroactively, which means that the Cabinet will also

⁹ It is assumed that the government will leave the budget balance unchanged. In the variant, budgetary neutrality is attained by reducing wage and income tax.

critically review whether earlier national additions could have been dispensed with. For instance, over two-thirds of the national component of the Working Conditions Act (Arbowet) is to be scrapped next year.

At the same time, the business sector is indicating that it is hindered by what it calls “Brussels bureaucracy”. Indeed, a substantial part of our laws and administrative rules come from “Europe”. During the Dutch Presidency of the EU last year, the Netherlands called upon the European Commission to give priority to improving European rules. The Commission has recently decided to measure the administrative burden. This is a milestone, providing an instrument for improving entrepreneurial conditions in the European context, too.

Chapter 6 Sustainability of public finances

Augmenting the economic base for public amenities is crucial to being prepared for ageing, and increases prosperity for Dutch citizens. On the basis of this conviction, substantial reforms have been or are about to be implemented with regard to incapacity, early retirement, unemployment benefits (to foster participation and sustainable public finances) and health care (with the focus on accessibility and sustainable public finances). In addition, the supervision exercised on pension funds has been stepped up. The above reforms are discussed in more detail below.

Labour market reforms

The first step towards increasing the labour supply is adjustment of the incapacity scheme, in two stages. In the first stage, paid sick leave during the second year and new assessment rules took effect. The second stage (as from 1 January 2006) entails the introduction of the Act on Work and Income according to Capacity for Work (*Wet Werk en Inkomen naar Arbeidsvermogen (WIA)*). Under this Act, employees still capable of work are stimulated to find a job. The Cabinet's aim for 2007 is to limit the annual inflow into disability schemes to at most 25,000 persons who are fully and permanently disabled.

Apart from revising the disability scheme, the Cabinet is no longer facilitating early retirement. This is in line with the objective to keep older employees involved in the labour process. Finally, the Cabinet has transferred the responsibility for the implementation of the new Act on Work and Social Assistance (*Wet Werk en Bijstand*) to the municipalities. In this area, the municipalities have a large measure of discretion; financial incentives encourage them to work as effectively as possible.

The labour market has been made more flexible by the introduction of the Act on Flexibility and Certainty (*Wet Flexibiliteit en Zekerheid*), which provides for flexibilisation of temporary labour. Employers can now offer three successive contracts, covering a total period of three years. This has put the Netherlands among the top ten countries with a flexible dismissal system, on the OECD list of protection against dismissal for temporary workers. According to the same OECD indicator of employment protection, employees with fixed contracts continue to be heavily protected against dismissal. The Netherlands' administrative procedures on this point are considered especially cumbersome. The Cabinet's proposals to abandon the culpability check and the LIFO (last-in-first-out) principle will alleviate the administrative procedures. Furthermore, the maximum period during which an unemployed person can receive a benefit will be reduced from five years to three years and two months.

According to CPB calculations, the labour supply will expand structurally by 70,000 persons in 2005 and 2006, thanks largely to policy measures.

Public finances

The Cabinet's reform agenda will improve the long-term sustainability of public finances by widening the base for public amenities.

Early next year, both the CPB and the European Commission will come with an update of the so-called ageing projections. These provide new insight into the financial sustainability of Dutch public finances in the longer term. In spite of the positive influence of the recent reforms, sustainability is also subject to downward effects. For instance, the new ageing projections, both by the CPB and the European Commission, reckon with a structurally lower interest rate level. This lower rate has a negative impact on public finances because ageing compels us to save for future budget deficits. The low interest rate makes for a higher net cash value of these deficits, so that more will need to be saved now.

The analyses of the CPB and the European Commission form an important point of departure for the next Cabinet to meet the challenge posed by ageing. Table 6.1 presents the figures contained in the 2004 Stability Programme. This Table is included because the CPB and the AWG will be publishing new figures shortly. Table 7 in Annex 1 gives an overview of the provisional AWG figures.

Table 6.1 Long-term sustainability of public finances – Stability Programme 2004

% of GDP	2010	2020	2030	2050
Total general government expenditure	48.0	49.8	55.5	56.3
Pensions	5.3	6.7	8.9	8.3
Health care	7.7	8.7	10.7	10.7
Interest expenditure	2.5	2.2	2.6	5.7
Total revenues	44.6	45.7	48.1	47.7
Assumptions				
Labour productivity growth (%)	1¾	1¾	1¾	1¾
Real GDP growth (%)	1.8	1.6	1.4	1.8
Participation rate males	82.0	81.2	81.5	81.8
Participation rate females	66.3	72.6	72.9	73.2
Total participation rate	75.0	76.5	76.8	77.1
Unemployment rate (% of labour force)	4	4	4	4

Source: Government calculations in line with the picture presented in 'Ageing in the Netherlands'

Health care

In order to keep the costs of health care in check, given demographic ageing, the Dutch government has introduced a new health care system. The new system incorporates stronger incentives towards cost control, while accessibility is guaranteed by an acceptance obligation and care allowances for lower income categories. Sound and accessible health care is a major precondition for a higher participation rate for the labour force in general and for older workers in particular.

Pensions

To ensure adequate supervision on the financial position of pension funds, a Financial Assessment Framework (*Financieel Toetsingskader/FTK*) has been drawn up. The Framework guarantees that pension commitments are really met. Among other things, it requires (1) where unconditional commitments are concerned, a certainty of 97.5% that a fund will not be confronted by under-funding within a year (for a standard pension fund, this means a funding ratio of 130%), (2) that pension fund liabilities must be marked to market and (3) that the expectations raised must correspond with the financing and actual meeting of conditional commitments.

While a structurally sound funding rate must give pension fund participants sufficient confidence, it is also important that pro-cyclical effects be prevented. The Framework stimulates 'sound' pension funds with adequate funding rates to operate in a non-pro-cyclical manner, and to accumulate extra buffers in good times. When the tide turns, the fund can use these extra buffers to continue to meet the conditions set by the Framework. The Framework further contains stipulations which are intended to limit any pro-cyclical effects: (1) a pension fund is permitted to take at most 15 years to bring its pension assets back to the required level (130% for an average pension fund) when the buffer is insufficient, (2) contribution fluctuations are tempered by the use of a special discount rate for self-funding contributions, (3) finally, prudential supervision makes it possible for the supervisor to apply the ultimate instrument, a tailored approach.

Over the past few years, many pension funds switched from a (mitigated) final pay system to a conditionally indexed average pay system. The indexation instrument can consequently be applied not only to pensions already being paid to pensioners, but also to employees' future pension entitlements. This means that the funding ratio is affected more profoundly by pension fund decisions on the level of indexation. The consequences of limiting indexation are thus borne by employees and pensioners alike. An effective indexation instrument is all the more important now that the ratio of employees to pensioners is deteriorating because of ageing, and the contribution instrument is becoming less effective as a way of redressing any asset shortages at pension funds.

Chapter 7 Budget framework

Budgetary rules during the current Cabinet term

In its 2003 Coalition agreement, the Cabinet formulated the budgetary rules for its 2003-2007 term. The current rules are underlain by the trend-based fiscal policy from the period 1994-2003. With a view to the necessary calm in the budgetary process, budgetary decision-making, both on expenditures and revenues, takes place once during the spring, the so-termed main decision-making moment. The budget is furthermore based on conservative assumptions. Moreover, expenditures and receipts are strictly segregated. Expenditures are limited with the aid of fixed real expenditure ceilings, set for the entire term, until end-2007. On the revenues side (taxes and social insurance contributions), the automatic stabilisers are, in principle, permitted to operate freely. However, with a view to caution and given European agreements, “freely” is subject to limitations.

In addition, the rules on budget discipline apply. These are a set of detailed rules governing the daily budgetary situation. They provide, among other things, that budgetary over- and underspending must be reported to the Minister of Finance in time, and that each overrun must be compensated. The rules apply to the narrowly defined Central Government Budget, Social Security and Labour Market Policy and the Health Care Sector. Where the narrowly defined Central Government Budget is concerned, the rules apply to each departmental budget and the appurtenant medium-term figures.

Habitually, in the year prior to elections, the official Study Group on the Budget Margin gives advice about the fiscal policy to be pursued during the next Cabinet term. This means that the Study Group will present its advice before the summer of 2006 (as general elections are foreseen for 2007).

Expenditure limited by means of fixed ceilings

Budget expenditures are kept in check by means of fixed real expenditure ceilings. Actual expenditure (in nominal terms) is held up against these ceilings. To this end, real expenditures are adjusted for nominal developments. The price component of the National Expenditures is used as a measure of nominal developments. The spending ceilings are fixed for every budgetary year up to the end of 2007, when the Cabinet term runs out. The framework applies to the three so-termed budget discipline sectors: the narrowly defined Central Government Budget, Social Security and Labour Market Policy and the Health Care Sector. Basically, a real spending ceiling is set for every sector, which may not be exceeded. If total setbacks exceed total windfalls within one of the three budget discipline sectors (or on a budget), austerity measures must be taken to compensate for the shortfall. Whether specific expenditures do or do not qualify under the spending framework depends, in principle, on whether they are relevant for the calculation of the general government balance; if they are, they are also relevant for the expenditure framework.

Automatic stabilisation on the revenues side

The revenues side is made up of taxes and social insurance contributions¹⁰. On the revenues side, the automatic stabilisers should be able to operate freely, with the proviso that, for the sake of caution, a signal value for the general government deficit of 2.5% applies as limitation to “freely”. If this signal value threatens to be exceeded, further measures are taken by the Cabinet. This also holds when the necessary reduction of the structural balance, by 0.5% of GDP, threatens to fall through.

Testing expenditure ceilings

In the following table, the expenditures of the budget discipline sectors are held up against the expenditure ceilings for the period 2005-2007. For 2005, the table shows underspending below the overall ceiling of nearly EUR 1 billion. It is estimated that in both 2006 and 2007 the overall ceiling will be nearly reached. This means that for each of these three years, the expenditure ceiling provided for in the Coalition agreement will be adhered to.

Table 7.1.1 Expenditure ceilings 2005 – 2007 broken down by budget discipline sector (EUR billion)

	2005	2006	2007
Expenditure ceiling narrowly defined Central Government Budget	94.5	97.5	100.9
Expenditure level narrowly defined Central Government Budget	93.7	97.3	101.2
Under/overspending	-0.8	- 0.2	0.3
Expenditure ceiling Social Security and Labour Market	58.3	57.7	58.2
Expenditure level Social Security and Labour Market	57.8	57.3	57.5
Underspending	-0.5	-0.3	-0.8
Expenditure ceiling Health Care	41.7	43.4	46.0
Expenditure level Health Care	42.2	43.8	46.3
Overspending	0.5	0.3	0.3
Expenditure reserve	-	0.2	0.2
Total over/underspending	-0.9	0.0	0.0

Separate arrangements for local government

The expenditure ceilings apply to the public sector, excluding local government. In the Netherlands, local government forms a separate layer of government, independent of central government¹¹. Since the local government's balance on expenditure and revenues showed an unexpectedly large deficit of 0.6% of GDP in 2003, an administrative arrangement was concluded between the Cabinet and the representative organisations of the municipalities, provinces and

¹⁰ Non-tax revenues are netted with expenditures and form part of the expenditure framework,

¹¹ Local government is financed, for 80%, from central government transfers and, for 20%, from taxes which they levy themselves.

water boards. The objective of this arrangement is to gain greater control over this balance. The parties involved monitor the local government's deficit to ensure that it does not exceed 0.5 percentage point of GDP. In addition, a working group will draw up a structural ceiling system to control the local government balance. It has also been decided that local government will provide more and better information about their expenditures and revenues.

Statistical governance

In the Netherlands, statistics on public finances in past years are compiled by Statistics Netherlands (CBS), the national statistical agency. The CBS also compiles quarterly figures on public finances. The CBS has the legal status of an independent public body and operates on the basis of an independent statute. Its independence allows it to compile reliable and qualitatively high-grade statistics on public finances. In 2005, the CBS and the Ministry of Finance concluded a protocol on the Netherlands' reports on the general government balance and debt (the semi-annual notifications on the general government deficit and debt, the quarterly public finance accounts and the 31 March report) to the European Commission. The protocol contains agreements about the responsibilities and division of tasks of the CBS and the Ministry of Finance regarding these reports. The Ministry of Finance compiles figures on public finance for the future. These calculations are based on economic forecasts made by the CPB, which also has an independent statute.

ANNEX I Tables

Table 1a Macroeconomic prospects

	ESA Code	2004	2004	2005	2006	2007	2008
		level	rate of change	rate of change	rate of change	rate of change	rate of change
Real GDP	B1*g	488.6	1.7	$\frac{3}{4}$	$2\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{4}$
Nominal GDP	B1*g	488.6	2.6	$2\frac{1}{4}$	$3\frac{3}{4}$	$3\frac{1}{2}$	$3\frac{1}{4}$
Components of real GDP							
Private consumption expenditure	P.3	239.2	0.0	$1\frac{1}{2}$	-2	$1\frac{3}{4}$	2
Government consumption expenditure	P.3	118.5	0.0	$\frac{1}{2}$	$9\frac{1}{4}$	$1\frac{1}{2}$	$1\frac{1}{2}$
Gross fixed capital formation	P.51	81.0	4.9	$1\frac{1}{2}$	$5\frac{3}{4}$	5	4
Changes in inventories (Δ)	P.52+P.53	0.8	0.8	$-\frac{3}{4}$	$\frac{1}{4}$	0	0
Exports of goods and services	P.6	328.1	8.5	$4\frac{1}{4}$	$5\frac{3}{4}$	$5\frac{3}{4}$	$5\frac{1}{2}$
Imports of goods and services	P.7	292.6	7.8	$3\frac{3}{4}$	$6\frac{1}{2}$	$4\frac{1}{2}$	$4\frac{3}{4}$
Contributions to real GDP growth							
Final domestic demand		-	0.6	$\frac{1}{2}$	2	$1\frac{1}{2}$	$1\frac{1}{2}$
Changes in inventories (Δ)	P.52+P.53	-	0.2	$-\frac{1}{4}$	0	0	0
External balance of goods and services	B.11	-	0.9	$\frac{1}{2}$	$\frac{1}{2}$	1	$\frac{3}{4}$

Table 1b Price developments

	ESA Code	2004	2004	2005	2006	2007	2008
		level	rate of change	rate of change	rate of change	rate of change	rate of change
GDP deflator		100	0.9	$1\frac{1}{4}$	1	1	1
Private consumption deflator		100	1.1	$1\frac{1}{2}$	$1\frac{3}{4}$	$1\frac{1}{2}$	$1\frac{1}{2}$
HICP		100	1.4	1.5	1.5	1.1	
Public consumption deflator		100	2.2	1	2	1	1
Investment deflator		100	1.6	$1\frac{1}{4}$	1	1	1
Export price deflator		100	0.4	$2\frac{3}{4}$	$1\frac{1}{4}$	1	1
Import price deflator		100	1.1	$3\frac{1}{2}$	$1\frac{3}{4}$	1	1

Table 1c Labour market developments

	ESA Code	2004	2004	2005	2006	2007	2008
		level	rate of change	rate of change	rate of change	rate of change	rate of change
Employment (x thousand persons)		8157	-1.4	-¼	1½	1¾	1¾
Employment (hours worked)		11.48	-1.5	-¼	1¼	1	1¼
Unemployment (% of labour force)		479	6.4	6½	6	5¼	4¾
Labour productivity (persons)		60.5	3.4	1¼	1½	1½	1½
Compensation of employees	D.1	249.9	1.5	1¼	2¼	2½	2½

Table 1d Sectoral balances

	ESA Code	2004	2004	2005	2006
		level	rate of change	rate of change	rate of change
Net lending/borrowing vis-à-vis the rest of the world	B.9	30.1	7.0	6.0	-0.7
Net lending/borrowing of the private sector		39.2	6.8	7.3	-0.4
Net lending/borrowing of general government		-9.1	6.1	11.9	0.5

Table 2 General government budgetary prospects

	ESA Code	2004	2004	2005	2006	2007	2008
		level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B9) by subsector							
1. General government	S.13	-10074	-2.1	-1.2	-1.5	-1.2	-1.1
2. Central government	S.1311	-8579	-1.8	-1.1	-1.5	-1.8	-2.2
3. State government	S.1312	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	-2119	-0.4	-0.4	-0.3	-0.2	-0.1
5. Social security funds	S.1314	624	0.1	0.3	0.3	0.9	1.3
General government (S13)							
6. Total revenue	TR	217366	45.0	46.0	47.3	46.9	47.0
7. Total expenditure	TE	227440	47.1	47.2	48.8	48.1	48.1
8. Net lending/borrowing	EDP B9	-10074	-2.1	-1.2	-1.5	-1.2	-1.1
9. Interest expenditure	EDP D.41 Incl. FISIM	13024	2.7	2.6	2.6	2.6	2.6
PM: 9a. FISIM		449	0.1	0.1	0.1	0.1	0.1
10. Primary balance		2950	0.6	1.4	1.1	1.4	1.5
Selected components of revenue							
11. 11=11a+11b+11c) Total taxes		113790	23.5	24.1	23.4	23.4	23.4
11a. Taxes on production and imports	D.2	61053	12.6	12.9	12.5	Optional	Optional
11b. Current taxes on income, wealth etc.	D.5	51224	10.6	10.9	10.6	Optional	Optional
11c. Capital taxes	D.91	1513	0.3	0.3	0.3	Optional	Optional
12. Social contributions	D.61	73414	15.2	15.1	16.8	Optional	Optional
13. Property income	D.4	10133	2.1	2.1	2.1	Optional	Optional
14. Other (14=15-(11+12+13))		30162	6.3	6.8	7.0	Optional	Optional
15.=6. Total revenue	TR	217366	45.0	46.0	47.3	Optional	Optional
PM: Tax burden (D.2+D.5++D.61+D.91-D995)		187204	38.7	39.2	40.3	40.2	40.2
Selected components of expenditure							
16. Collective consumption	P.32	51655	10.7	10.7	10.5	10.5	10.5
17. Total social transfers	D.62+D.63	123033	25.5	25.5	27.1	26.6	26.6
18.=9. Interest expenditure	EDP D.41	13024	2.7	2.6	2.6	2.6	2.6

	incl. Fisim						
19. Subsidies	D.3	6895	1.4	1.3	1.2	1.2	1.2
20. Gross fixed capital formation	P.51	15215	3.1	3.1	3.0	3.0	3.0
21. Other (21=22-(16+17+18+19+20))		17618	3.7	4.0	4.4	4.2	4.2
22.=7. Total expenditure	TE	227440	47.1	47.2	48.8	48.1	48.1

Table 4 General government debt developments

% of GDP		2004	2005	2006	2007	2008
1. Gross debt		53.1	54.4	54.5	53.9	53.1
2. Change in gross debt ratio		+0.5	+1.3	+0.1	-0.6	-0.8
Contributions to changes in gross debt						
3. Primary balance (minus sign = surplus)		-0.6	-1.4	-1.1	-1.4	-1.5
4. Interest expenditure		2.7	2.6	2.6	2.6	2.6
5. Stock-flow adjustment		-1.6	0.1	-1.4	-1.8	-1.9
PM: implicit interest rate		5.1	4.9	4.8	4.8	4.8

Table 5 Cyclical developments

	ESA Code	2004	2005	2006	2007	2008
Real GDP growth		1.7	$\frac{3}{4}$	$2\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{4}$
Net lending of general government	EDP B.9	-2.1	-1.2	-1.5	-1.2	-1.1
Interest expenditure	EDP D.41+FISI M	2.7	2.6	2.6	2.6	2.6
Potential GDP growth		1.5	1.6	1.8	1.9	2.0
<i>Contributions to growth:</i>						
- Labour		0.24	0.30	0.30	0.31	0.30
- Capital		0.51	0.53	0.63	0.71	0.76
- Total factor productivity		0.75	0.78	0.82	0.87	0.91
Output gap		-1.6	-2.3	-1.5	-0.9	-0.6
Cyclical budgetary component		0.9	1.2	0.8	0.5	0.4
Cyclically-adjusted balance		-1.2	0.0	-0.7	-0.7	-0.7
Cyclically-adjusted primary balance		+1.5	+2.6	+1.9	+1.9	+1.9

Table 6 Divergencies from previous update

	ESA Code	2004	2005	2006	2007	2008
Real GDP growth (%)						
Previous update		$1\frac{1}{4}$	$1\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{2}$	-
Current update		1.7	$\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{2}$	$2\frac{1}{4}$
Difference		$\frac{1}{2}$	1	0	0	-
General government lending (% of GDP)	EDP B.9					
Previous update		-3.0	-2.6	-2.1	-1.9	-
Current update		-2.1	-1.2	-1.5	-1.2	-1.1
Difference		+0.9	+1.4	+0.6	+0.7	-
General government gross debt (% of GDP)						
Previous update		56.3	58.1	58.6	58.3	-
Current update		53.1	54.4	54.5	53.9	53.1
Difference		-3.2	-3.7	-4.1	4.4	-

Table 7 Sustainability of public finances in the long term – provisional AWG figures

Netherlands

EPC-AWG Pension expenditure projections

	2004	2010	2015	2020	2025	2030	2040	2050
Baseline scenario; as % of GDP								
Social security pensions, gross	7,7	7,6	8,3	9,0	9,7	10,7	11,7	11,2
Old-age and early pensions, gross	4,9	5,2	6,0	6,7	7,6	8,6	9,7	9,4
Of which: earnings-related pensions, gross	:	:	:	:	:	:	:	:
Private sector employees, gross	:	:	:	:	:	:	:	:
Public sector employees, gross	:	:	:	:	:	:	:	:
Other pensions (disability, survivors), gross	2,8	2,4	2,3	2,3	2,2	2,1	1,9	1,9
Occupational pensions, gross	4,6	4,7	5,2	5,8	6,7	7,7	9,0	8,7
Private mandatory pensions, gross	:	:	:	:	:	:	:	:
Total pension expenditure, gross	12,4	12,3	13,6	14,8	16,4	18,4	20,6	20,0
Social security pensions, net	6,2	6,2	6,8	7,4	8,1	8,9	9,8	9,4
Total pension expenditure, net	9,6	9,6	10,6	11,5	12,8	14,4	16,1	15,5
Social security pensions, contributions	6,8	6,4	6,4	6,4	6,4	6,5	6,7	6,6
Total pension contributions	13,0	12,7	13,1	13,5	13,4	13,2	12,9	12,9
Social security pensions, assets	:	:	:	:	:	:	:	:
All pensions, assets	135,5	160,6	177,5	195,6	214,5	230,1	241,0	243,7
Additional indicators								
Social security pensions, net / Social security pensions, gross,%	81	81	82	83	83	83	84	84
Total pension expenditure, net / Total pension expenditure, gross, %	77	78	78	78	78	78	78	78
Social security pensions, number of pensioners , 1000 pers.	3317	3437	3818	4156	4514	4879	5291	5120
All pensions, pensioners , 1000 pers.	:	:	:	:	:	:	:	:
Number of pensioners aged 65+ , 1000 pers.	:	:	:	:	:	:	:	:
Share of pensioners below age 64 as % of all pensioners	:	:	:	:	:	:	:	:
Average gross social sec. pension, 1000€in 2004 prices	10,9	11,5	12,4	13,4	14,4	15,6	18,3	21,8
Average gross total pensions, 1000€in 2004 prices	:	:	:	:	:	:	:	:
Output / Worker, 1000€in 2004 prices	55,7	61,3	66,7	72,6	79,1	86,2	102,2	121,0
Social sec. benefit ratio	19,5	18,8	18,6	18,4	18,2	18,1	18,0	18,1
Total pension benefit ratio	:	:	:	:	:	:	:	:
Social security pensions, num of contributors	12064	12484	12844	13156	13454	13612	13660	13615
Average social sec. pension contribution, 1000€in 2004 prices	2,6	2,6	2,8	3,0	3,2	3,4	4,1	4,9
Average total pension contribution, 1000€in 2004 prices	:	:	:	:	:	:	:	:
Support ratio (contributors /100 pensioners, social security pensions)	364	363	336	317	298	279	258	266
High life expectancy; as % of GDP								
Social security pensions, gross	7,7	7,6	8,4	9,0	9,9	10,8	12,0	11,7
Old-age and early pensions, gross	4,9	5,2	6,0	6,8	7,7	8,7	10,1	9,9
Total pension expenditure, gross	12,4	12,3	13,5	14,8	16,5	18,5	21,1	20,7
All pensions, assets	135,5	161,0	178,3	197,0	217,5	235,9	251,4	257,4
Higher Labour productivity; as % of GDP								
Social security pensions, gross	7,7	7,7	8,3	9,0	9,7	10,7	11,6	11,2
Old-age and early pensions, gross	4,9	5,2	6,0	6,7	7,6	8,6	9,7	9,3
Total pension expenditure, gross	12,4	12,3	13,6	14,7	16,3	18,2	20,4	19,6
All pensions, assets	135,5	160,5	176,1	192,2	210,1	225,4	236,3	239,3
Lower Labour productivity; as % of GDP								
Social security pensions, gross	7,7	7,6	8,3	8,9	9,7	10,7	11,7	11,3
Old-age and early pensions, gross	4,9	5,2	6,0	6,7	7,6	8,6	9,8	9,4
Total pension expenditure, gross	12,4	12,3	13,6	14,8	16,5	18,6	20,9	20,3
All pensions, assets	135,5	160,7	178,9	198,6	218,0	234,1	245,3	247,8
Higher Employment rate (1%); as % of GDP								
Social security pensions, gross	7,7	7,6	8,3	8,9	9,7	10,6	11,6	11,1
Old-age and early pensions, gross	4,9	5,2	6,0	6,7	7,5	8,5	9,7	9,3
Total pension expenditure, gross	12,4	12,3	13,5	14,7	16,3	18,3	20,5	19,9
All pensions, assets	135,5	160,1	176,3	194,4	213,6	229,7	241,5	244,7
Higher Older workers employment rate; as % of GDP								
Social security pensions, gross	7,7	7,6	8,3	8,9	9,6	10,6	11,6	11,1
Old-age and early pensions, gross	4,9	5,2	6,0	6,7	7,5	8,5	9,7	9,3
Total pension expenditure, gross	12,4	12,3	13,5	14,7	16,3	18,3	20,6	19,9
All pensions, assets	135,5	160,3	176,9	194,6	213,4	229,7	241,7	244,3
Lower interest rate; as % of GDP								
Social security pensions, gross	7,7	7,6	8,3	9,0	9,7	10,7	11,7	11,2
Old-age and early pensions, gross	4,9	5,2	6,0	6,7	7,6	8,6	9,7	9,4
Total pension expenditure, gross	12,4	12,2	13,2	14,3	15,8	17,8	20,1	19,7
All pensions, assets	135,5	166,9	189,2	211,4	235,2	256,1	275,9	284,3
Higher interest rate; as % of GDP								
Social security pensions, gross	7,7	7,6	8,3	9,0	9,7	10,7	11,7	11,2
Old-age and early pensions, gross	4,9	5,2	6,0	6,7	7,6	8,6	9,7	9,4
Total pension expenditure, gross	12,4	12,5	13,9	15,2	16,9	18,9	21,1	20,2
All pensions, assets	135,5	152,1	165,6	180,8	196,1	208,1	212,9	211,2

: = data not provided

ANNEX II Prosperity and consumer confidence

Over the past twenty years, consumer confidence and prosperity growth have shown a remarkably similar pattern (see Figure 2.1). However, causality cannot be determined on the basis of the correlation coefficient. However, insight can be gained into causality by looking at the relationship between prosperity growth over a year as a whole and consumer confidence in the second half of that year.

The correlation coefficient between per capita GDP growth over a year and consumer confidence in the second half of that year is 0.86. In nearly all euro area countries and the UK, prosperity growth shows a higher correlation with average consumer confidence in the second half of the year than with that in the year as a whole. This makes it unlikely that consumer confidence steers prosperity development. In fact, the opposite may be expected.

All in all, an increase in prosperity seems the best way to boost consumer confidence.

Table A2.1 Correlation between prosperity (per capita GDP) and consumer confidence (1985-2004)

	Correlation entire year	Correlation second half-year	Difference	Per capita GDP growth
NL	0.82	0.86	0.04	1.6
BE	0.49	0.63	0.14	1.7
DE	0.72	0.78	0.06	1.0
DK	0.49	0.49	0.00	1.4
EL	0.26	0.15	-0.11	1.6
ES	0.65	0.65	0.00	2.3
FR	0.71	0.78	0.07	1.5
IE	0.80	0.79	-0.01	3.7
IT	0.56	0.64	0.08	1.5
VK	0.46	0.51	0.05	2.0
PT	0.83	0.84	0.01	2.3

Source: Government calculations based on AMECO and European Commission.