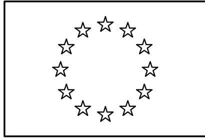

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 11.11.2009
SEC(2009) 1521 final

Recommendation for a

COUNCIL DECISION

on the existence of an excessive deficit in the Netherlands

EXPLANATORY MEMORANDUM

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States, to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future[1], although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation, and thereby ensuring long-term sustainability of public finances.

2. PREVIOUS STEPS IN THE EXCESSIVE DEFICIT PROCEDURE

Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[2], which is part of the Stability and Growth Pact.

According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level

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[1] See the Eurostat decision of 15 July 2009 on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis, Eurostat News Release No 103/209.

[2] OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm.

that comes close to the reference value; or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

On the basis of the data notified by the Dutch authorities in April 2009[3] and taking into account the Commission services' spring 2009 and September 2009 interim forecast, the Commission adopted a report under Article 104(3) for the Netherlands on 7 October 2009[4].

Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 October 2009.

3. THE EXISTENCE OF AN EXCESSIVE DEFICIT

According to data notified by the Dutch authorities in April 2009, the general government deficit in the Netherlands was planned to reach 3.3% of GDP in 2009, thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considered that although the deficit planned in the notification was close to the 3% of GDP reference value, based on the authorities 2010 budget memorandum published on 15 September showing a deficit of 4.8% of GDP in 2009 it was expected that the actual outcome would not be close to the threshold. The Commission also considered that the planned excess over the reference value could be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact, on the basis of the information available at the time of the report. Furthermore, the planned excess over the reference value could not be considered temporary.

According to more recent data notified by the Dutch authorities in October 2009, the general government deficit in the Netherlands is now planned to reach 4.8% of GDP in 2009, thus above and not close to the 3% of GDP reference value. Based on the Commission services' autumn 2009 forecast, the planned excess over the reference value still qualifies as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it results mainly from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. In the Commission services' 2009 autumn forecast GDP is expected to contract by 4.5% in 2009 and to grow by only ¼% in 2010. Furthermore, also on the basis of the Commission services' autumn 2009 forecast the planned excess over the reference value cannot be considered temporary, since the general government deficit is projected to come out

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[3] According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of the Netherlands can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables.

[4] All EDP-related documents for the Netherlands can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

at 4.7% of GDP in 2009, 6.1% of GDP in 2010, and 5.6% of GDP in 2011 on the basis of the usual no-policy change assumption. The deficit criterion in the Treaty is not fulfilled.

According to data notified by the Dutch authorities in October 2009, the general government gross debt is still slightly below the 60% of GDP reference value, at 59.7% of GDP in 2009[5]. The Commission services' autumn 2009 forecast expects the general government gross debt to come out at 59.8% of GDP in 2009 and to increase to around 66% of GDP in 2010 and 70% of GDP in 2011, thus exceeding 60% Treaty reference value. This increase stems in large part from an important expected deterioration of the primary balance.

In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these could only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of the Netherlands, the double condition is not met. Considered on their own merit, the relevant factors in the current case are on balance relatively favourable.

The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

The Commission, having taken into account its report under Article 104(3) and the opinion of the Economic and Financial Committee under Article 104(4), is of the opinion that an excessive deficit exists in the Netherlands. This opinion, adopted by the Commission on 11 November 2009, is herewith addressed to the Council according to Article 104(5). The Commission recommends that the Council shall decide accordingly, in conformity with Article 104(6). In addition, the Commission is submitting to the Council a recommendation for a Council recommendation to be addressed to the Netherlands with a view to bringing the situation of an excessive deficit to an end according to Article 104(7).

4. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 104(7) has to establish a deadline of six months at most for effective action to be taken by the Member State concerned as well as a deadline for the correction of the excessive deficit, which "should be completed in the year following its identification unless there are special circumstances". Article 2(6) of the Regulation implies that the "relevant factors" considered in the Commission report under Article 104(3) of the Treaty have to be taken into account in deciding whether special circumstances exist. Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation".

In the case of the Netherlands, special circumstances are considered to exist. Starting in the second quarter of 2008, the Netherlands recorded five quarters of negative q-o-q GDP growth. According to the Commission services 2009 autumn forecast, the downturn is concentrated in 2009, with an expected contraction of GDP of 4.5%, but economic activity is foreseen to

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[5] This figure does not include the government's illiquid asset back-up facility for ING, which amounts to around 3½% of GDP (EUR 21 billion).

remain subdued in 2010 with ¼% GDP growth, followed by 1½% in 2011. The downturn in the Netherlands reflects the sharp fall in exports, as a result of the fall in world trade.

The stimulus measures taken by the Netherlands following the EERP, the functioning of the automatic stabilisers and decreasing gas revenues contribute to the planned excessive deficit in 2009. Fiscal consolidation in good times and the absence of large external imbalances allowed the Dutch authorities to implement a sizeable welcome stimulus of about 2% of GDP. The stimulus measures are broadly in line with the EERP, as they are timely, targeted and partially temporary. The 2010 budget memorandum dating from September 2009 expects the deficit to come out at 4.8% of GDP in 2009 and to deteriorate further in 2010 to 6.3% of GDP. According to the Commission services' autumn 2009 forecast, the deficit is expected to reach 4.7% of GDP in 2009, 6.1% of GDP in 2010, and 5.6% of GDP in 2011 on the basis of the usual no-policy change assumption. This assumption takes into account that, according to government plans, a large part of the measures of extraordinary nature linked to the crisis in line with the EERP will be maintained in 2010 but rolled back in 2011. The overall stimulus amounts to around 1% of GDP in both 2009 and 2010. While about two thirds of the stimulus measures are temporary, about one third of them, like the lowering of social contributions and the plane ticket tax, is considered permanent. The assumption also takes into account the planned additional consolidation measures amounting to 0.3% of GDP, starting in 2011.

Considering the special circumstances, and the EERP framework, an average annual structural budgetary adjustment is recommended. The required adjustment should take into account the fiscal room for manoeuvre which is assessed on the basis of all factors relevant for achieving the fiscal policy objectives, starting with the level of the general government deficit and gross debt as well as other indicators, such as the current account position, the level of contingent liabilities of the financial sector, interest payments, risk premia and the expected change in age-related expenditure in the medium term. In calculating the average annual adjustment, the 2011 deficit in the Commission services' autumn 2009 forecast is taken as the starting point. The total structural adjustment needed to reach the nominal deficit target of 3% by the deadline is then calculated by assuming a gradual closure of the output gap by 2015.

Against this background, and in view of the relatively good fiscal starting position and stable current account surpluses, it is appropriate to consider the correction of the excessive deficit in a medium-term framework with a deadline for the correction of 2013. A credible and sustainable adjustment path would require the Dutch authorities to implement the fiscal measures in 2010 as envisaged. In order to bring the deficit below the reference value by 2013, the Netherlands should ensure an average annual structural budgetary adjustment of ¾% of GDP over the period 2011-2013, which should also contribute to halting the rapid rise of the government gross debt ratio, which is forecast to breach the reference value. Also, it would be appropriate to specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit in case economic or budgetary conditions turn out better than currently expected.

Despite a sharp increase in 2008, mostly due to government operations to stabilise the financial markets amounting to approximately 15% of GDP, the general government gross debt is foreseen to still be slightly below the 60% of GDP reference value in 2009, at 59.7% of GDP, according to data notified by the Dutch authorities in October 2009. Based on the Commission services' autumn 2009 forecast, the general government gross debt is expected to come out at 59.8% of GDP in 2009 and to increase to around 66% of GDP in 2010 and 70% of GDP in 2011, thus exceeding 60% Treaty reference value. The increase in 2009-2011 stems in large part from an important expected deterioration of the primary balance.

In general, budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy. In particular, the Netherlands should develop further measures, including fostering labour market transitions within an integrated flexicurity approach, to improve the participation of women, older workers and disadvantaged groups with a view to raising overall hours worked.

As regards long-term sustainability of public finances, the long-term budgetary impact of ageing in the Netherlands is well above the EU average, mainly as a result of a relatively high increase in pension and long-term care expenditure as a share of GDP over the coming decades. High primary surpluses and a further reform of the social security system aimed at curbing the substantial increase in age-related expenditures would contribute to reducing risk to the long-term sustainability of public finances as defined by the Commission Communication[6] on 'Long-term sustainability of public finances for a recovering economy' and endorsed by the ECOFIN Council[7] on 10 November 2009. The implementation of recently planned measures, in particular the increase in the retirement age, is also expected to contribute to long-term sustainability.

Enhanced surveillance under the EDP, which seems necessary also in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit. In this context, a separate chapter in the updates of the Dutch stability programme, which will be prepared between 2009 and 2013, could usefully be devoted to this issue.

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6 Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf

7 Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011
Real GDP (% change)	COM forecast	3.6	2.0	-4.5	0.3	1.6
	2010 Budget memo	3.6	2.0	-4.7	0.0	n.a.
Output gap[1] (% of potential GDP)	COM forecast[2]	2.9	3.2	-2.5	-3.1	-2.6
	2010 Budget memo	n.a.	n.a.	n.a.	n.a.	n.a.
General government balance (% of GDP)	COM forecast	0.2	0.7	-4.7	-6.1	-5.6
	2010 Budget memo	0.2	0.7	-4.8	-6.3	-5.6
Primary balance (% of GDP)	COM forecast	2.4	2.8	-2.3	-3.7	-3.1
	2010 Budget memo	n.a.	n.a.	n.a.	n.a.	n.a.
Cyclically-adjusted balance[1] (% of GDP)	COM forecast	-1.3	-1.0	-3.2	-4.4	-4.3
	2010 Budget memo	n.a.	n.a.	n.a.	n.a.	n.a.
Structural balance[3] (% of GDP)	COM forecast	-1.3	-1.0	-3.6	-4.4	-4.3
	2010 Budget memo	n.a.	n.a.	n.a.	n.a.	n.a.
Government gross debt (% of GDP)	COM forecast	45.5	58.2	59.9	65.6	69.7
	2010 Budget memo	45.5	58.2	59.7	65.7	69.5

Notes:

[1] Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.
[2] Based on estimated potential growth of 1.7%, 1.7%, 1.1%, 0.7% and 0.9% respectively in the period 2007-2011.

[3] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0% of GDP in 2007, 0% of GDP in 2008, *0.4% of GDP in 2009 (deficit reducing), 0% of GDP in 2010 and 0% of GDP in 2011* according to the Commission services' autumn 2009 forecast.

Source:

Authorities' 2010 Budget memorandum; Commission services' autumn 2009 forecasts (COM); Commission services' calculations.

Recommendation for a

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(6) thereof,

Having regard to the recommendation from the Commission,

Having regard to the observations made by the Netherlands,

Whereas:

(1) According to Article 104 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The excessive deficit procedure (EDP) under Article 104, as clarified by Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[8] (which is part of the Stability and Growth Pact), provides for a decision on the existence of an excessive deficit. The Protocol on the excessive deficit procedure annexed to the Treaty sets out further provisions relating to the implementation of the EDP. Council Regulation (EC) No 479/2009[9] lays down detailed rules and definitions for the application of the provision of the said Protocol.

(4) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(5) Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. Having taken into account its report in accordance with Article 104(3)

[8] OJ L 209, 2.8.1997, p. 6.
[9] OJ L 145, 10.6.2009, p. 1-9.

and having regard to the opinion of the Economic and Financial Committee in accordance with Article 104(4), the Commission concluded that an excessive deficit exists in the Netherlands. The Commission therefore addressed such an opinion to the Council in respect of the Netherlands on 11 November 2009[10].

(6) Article 104(6) of the Treaty states that the Council should consider any observations which the Member State concerned may wish to make before deciding, after an overall assessment, whether an excessive deficit exists. In the case of the Netherlands, this overall assessment leads to the following conclusions.

(7) According to data notified by the Dutch authorities in October 2009 the general government deficit in the Netherlands is planned to reach 4.8% of GDP in 2009, thus above and not close to the 3% of GDP reference value. The planned excess over the reference value can be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. It results mainly from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. In the Commission services' 2009 autumn forecast GDP is expected to contract by 4.5% in 2009 and to grow by only ¼% in 2010. Furthermore, also on the basis of the Commission services' autumn 2009 forecast the planned excess over the reference value cannot be considered temporary, since the general government deficit is projected to increase from 4.7% of GDP in 2009 to 6.1% of GDP in 2010 before it declines slightly to 5.6% of GDP in 2011 based on the usual no-policy change assumption. The deficit criterion in the Treaty is not fulfilled.

(8) According to data notified by the Dutch authorities in October 2009, the general government gross debt is below the 60% of GDP reference value, at 59.7%[11] of GDP in 2009. The Commission services' autumn 2009 forecast expects the general government gross debt to come out at 59.8% of GDP in 2009 and to increase to around 66% of GDP in 2010 and 70% of GDP in 2011, thus exceeding the 60% of GDP reference value. This increase stems in large part from an important expected deterioration of the primary balance.

(9) According to Article 2(4) of Council Regulation (EC) No 1467/97, "relevant factors" can only be taken into account in the steps leading to the Council decision on the existence of an excessive deficit in accordance with Article 104(6) if the double condition - that the deficit remains close to the reference value and that its excess over the reference value is temporary - is fully met. In the case of the Netherlands, this double condition is not met. Therefore, relevant factors are not taken into account in the steps leading to this decision.

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[10] All EDP-related documents for the Netherlands can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

[11] This figure does not include the government's illiquid asset back-up facility for ING, which amounts to around 3½% of GDP (EUR 21 billion).

HAS ADOPTED THIS DECISION:

Article 1

From an overall assessment it follows that an excessive deficit exists in the Netherlands.

Article 2

This decision is addressed to the Netherlands.

Done at Brussels,

For the Council
The President