COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.5.2005
SEC(2005) 642 final

Recommendation for a

COUNCIL DECISION

abrogating the decision of 2 June 2004 on the existence of an excessive deficit in the Netherlands

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. INTRODUCTION

On 31 March 2004, the Commission received official confirmation from the Dutch authorities that the general government deficit in 2003 had reached 3.2% of GDP[1], therefore exceeding the reference value of the Treaty. Based on this evidence, the Commission initiated the Excessive Deficit Procedure (EDP) for the Netherlands on 28 April 2004, with the adoption of the report foreseen in Article 104(3) of the Treaty. Having taken into account all relevant factors embodied in this report and the opinion of the Economic and Financial Committee in accordance with Article 104(4), the Commission adopted an Opinion (in accordance with Article 104(5)) on 19 May 2004 stating that an excessive deficit existed in the Netherlands. On 2 June 2004, the Council adopted a Decision[2] to that effect, in accordance with Article 104(6).

At the same time, the Council adopted a Recommendation addressed to the Netherlands, in conformity with Article 104(7) of the Treaty, with a view to bringing the situation of an excessive government deficit to an end. Specifically, the Council recommended that "the Dutch authorities should put an end by 2005 at the latest to the present excessive deficit situation in accordance with Article 3(4) of Council Regulation (EC) No 1467/97." The Council established the deadline of 2 October 2004 for the Dutch government to "take action regarding corrective measures in 2005, mainly of a structural nature, amounting to at least half a percentage point of GDP".

In making recommendations for the correction of the excessive deficit, the Council stressed that "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." Moreover, it urged the Dutch authorities to ensure that "budgetary consolidation towards a position close to balance or in surplus is sustained, in particular through a reduction in the cyclically-adjusted deficit by at least 0.5 percentage point of GDP per year, even after the excessive deficit has been corrected."

On 6 October 2004 the Commission concluded[3] that the Dutch government had taken effective action by the deadline of 2 October 2004, of which the Council took note on 21 October[4].

2. CORRECTION OF THE EXCESSIVE DEFICIT IN 2004

On 16 April 2004, shortly after it had become apparent that the 3% of GDP reference value had been exceeded in 2003 against the background of a prolonged economic downturn, the Dutch government introduced a package of additional savings measures for 2004, equivalent

1 This was an upward revision from the 2.98% of GDP deficit notified on 1 March 2004. It was mainly due to a higher-than-expected deficit for local government, for which no preliminary data for the full year 2003 had been available earlier.

2 Council Decision 2005/136/EC published on 18.2.2005 in the OJ L 47, p. 26.

3 http://europa.eu.int/comm/economy_finance/about/activities/sgp/edp/comm_inf_note_en.pdf

4 Council of the European Union, press release 13017/04 (Presse 284) of 21.10.2004.

to 0.5% of GDP, with the aim of correcting the excessive deficit already in 2004. This package came on top of the savings that had been introduced in the 2004 budget[5]. Roughly half of the package consisted of measures of a structural nature, in particular higher premia for health insurance, lower health expenditure, and the phasing out of subsidies on the employment of low-skilled workers. The other half consisted of one-off measures that had a deficit-reducing impact only in 2004. The most important one-off measures related to shifts in the time profile of development aid expenditure, the recording of central bank profits, and lower-than-foreseen expenditure on infrastructure investment.

The March 2005 EDP notification (which was submitted on 28 February 2005 and validated by Eurostat on 18 March 2005), estimated the general government deficit in 2004 at 2.5% of GDP (table 1). On 31 March 2005, the 2004 deficit was revised to 2.3% of GDP in the regular reporting of revised accounts for general government to Eurostat, taking into account more complete information on the finances of local government.

This outcome compares with an expected deficit of 3.0% for 2004 of GDP in the 2005 budget and the November 2004 update of the stability programme, and with a projection of 2.9% of GDP in the Commission services' Autumn 2004 forecast. The better-than-expected outcome compared to the estimate in the 2005 budget is partly due to the fact that towards the end of 2004 tax revenue in most major tax categories was more buoyant than expected earlier. High oil prices and associated higher government revenues from the sale of natural gas further boosted receipts. Moreover, expenditure growth was lower than projected, mainly due to the slower growth in unemployment benefits, lower-than-projected infrastructure investment and lower net contributions to the EU. According to the Commission services spring 2005 forecast, the cyclically adjusted deficit fell from 2.0% of GDP in 2003 to 1.2% of GDP in 2004.

In 2004, the gross government debt-to-GDP ratio increased to 55.2% of GDP[6], from 54.3% of GDP in 2003, mainly due to the weak economic situation and the existence of an appreciable nominal deficit. The debt ratio thus remained below the 60% of GDP reference value of the Treaty.

5 The 2004 budget had targeted a deficit of 2.3% of GDP, but that was on the basis of projections of the summer of 2003, which afterwards rapidly became outdated as the assumptions on economic growth were too high, and budgetary outturns that became available after the 2004 budget were worse than expected.

6 This is a downward adjustment in the updated national accounts data of 31 March 2005 compared to the debt ratio of 55.7% of GDP notified on 28 February 2005.

Table 1: Budgetary developments 2002-2004 (as % of GDP)

Outturn		2002	2003	2004
General government balance		-1.9	-3.2	-2.3
- Total revenue		45.9	45.8	45.5
Of which:	*current taxes*	12.0	11.2	11.0
	social contributions	14.9	15.5	15.1
- Total expenditure		47.8	49.0	48.0
Of which:	*collective consumption*	11.3	11.4	11.4
	social transfers	13.3	14.0	14.0
	interest expenditure	3.1	2.9	2.9
	gross fixed capital formation	3.6	3.6	3.5
Primary balance		1.1	-0.3	0.4
Pm	Tax burden	40.1	40.0	39.9
Government debt		52.6	54.3	55.7
Pm	Cyclically-adjusted balance[1]	-2.3	-2.0	-1.2
Pm	Cyclically-adjusted primary balance[1]	0.8	0.9	1.7
Pm	Real GDP[1] (annual percentage change)	0.6	-0.9	1.3

Interest expenditure, total expenditure and balances include swaps in line with the definitions used in the excessive deficit procedure.
[1] Commission services' Spring 2005 economic forecast.
Source: Commission services.

3. BUDGETARY PROSPECTS FOR 2005 AND 2006

The budget for 2005 was presented to Parliament on 21 September 2004 and adopted with some relatively minor modifications shortly afterwards. It contains further deficit-reducing measures in 2005, comprising cuts in health care expenditure, increases in income tax rates, reduced access to unemployment benefits, and higher disability premia. The measures announced in the 2005 budget (which include the structural part of the measures in the 16 April 2004 package) add up to an adjustment of half a percentage point of GDP for 2005. Overall, the corrective measures appear to be for the largest part of a structural nature.

According to the Commission services' Spring 2005 forecast, the general government deficit for 2005 is projected at 2.0% of GDP (table 2). This compares with the official target set in the latest (March 2005) EDP notification of 2.1%[7]. Real GDP growth would slightly decelerate to 1.0% in 2005, from 1.4% in 2004. However, the forecast quarterly profiles show a gradual recovery in the course of the year, leading to a pick up in tax receipts, mainly on account of higher profits of corporations and self-employed persons. In addition, receipts from the sales of natural gas are expected to boost revenue also in 2005. On the expenditure side, the expenditure ratio is expected to fall slightly in 2005. Subdued government

[7] The slightly lower starting point for the 2004 deficit than that entailed in the Commission services' Spring forecast may lead to a favourable base effect in 2005. However, on current information it is not clear how much of the improvement in the finances of local government in 2004 will be structural, with a positive impact also on later years.

expenditure growth reflects the impact of savings measures, and the zero increase in the contractual wage rates of civil servants and in social security payments.

For 2006, the Commission services' Spring 2005 forecast projects real GDP growth to increase to 2.0% in 2006, leading to an acceleration of revenue in line with the expected economic upturn. However, based on current policy assumptions, the headline deficit would only improve relatively modestly, to 1.6% of GDP from 2.0% of GDP in 2005 as further savings on social security, subsidies and public sector wages would be accompanied by increased expenditure on transport, security, the knowledge-based economy, and compensations to limit the impact of the health insurance reform on household income.

The cyclically adjusted deficit is expected to improve markedly in 2005, reaching 0.4% of GDP, reflecting the ongoing budgetary consolidation. This would mean an improvement by 0.8% of GDP for the second consecutive year, which is larger than the minimum 0.5% of GDP adjustment in the years following the correction of the excessive deficit urged by the Council. It also implies that the Netherlands would achieve already in 2005 a budgetary position close to balance, in cyclically adjusted terms. Under present policies, the Commission services' Spring forecast expects the cyclically-adjusted balance to continue improving by attaining equilibrium in 2006. The large difference between the headline and the cyclically adjusted deficit reflects the prolonged economic downturn and the gradual expected recovery. Real GDP growth fell below the rate of potential growth in 2001 and is expected to reach potential again only in 2006. Hence, the negative output gap would widen from an estimated 1.9% of GDP to in 2003 to some 2.5% of GDP in 2005 and 2006.

According to the March 2005 EDP notification, the general government debt would increase to 57.4% of GDP in 2005, a figure very close to the debt ratio of 57.6% of GDP projected in the Commission services' Spring 2005 forecast. In this year it is affected by the purchase of gas transport infrastructure, an operation of 0.6% of GDP. Under current policy assumptions, the debt ratio will increase slightly further in 2006, to 57.9% of GDP, according to the Commission services' Spring forecast. However, the debt ratio would remain below the 60% of GDP reference value.

Table 2: Projections for general government finances (as % of GDP)

	2004	2005		2006	
		SP	Comm.	SP	Comm. *(1)*
General government balance	-2.5	-2.6	-2.1	-2.1	-1.6
- Total revenue	45.5	44.9	45.8	44.6	47.6
Of which: current taxes	11.0	24.8	11.1	24.7	11.2
social contributions	15.1	13.9	15.0	13.9	16.9
- Total expenditure	48.0	47.5	47.9	46.7	49.3
Of which: - collective consumption	11.4	17.5	11.4	17.2	11.4
- interest expenditure	2.9	2.9	2.9	2.8	2.8
- gross fixed capital formation	3.5	3.1	3.5	3.1	3.4
Primary balance	0.4	0.3	0.8	0.7	1.2
Government debt	55.7	58.1	57.6	58.6	57.9
Pm Cyclically-adjusted balance	-1.2	-1.2	-0.4	-1.3	0.0
Pm Cyclically-adjusted primary balance	1.7	0.3	2.5	0.7	2.9
Pm *Real GDP (annual percentage change)*	1.3	0.75	1.0	1.5	2.0

Sources: March 2005 EDP notification for 2004, the November 2004 update of the stability programme (SP), national accounts 2004 and the Commission services' Spring 2005 forecast (Comm.). Cyclically adjusted balance for the SP calculated by Commission services on the basis of inputs given in the programme (difference with Comm. reflects different macro-economic scenarios). Note that after the March 2005 EDP reporting, Statistics Netherlands published and reported to Eurostat a revised (lower) deficit for 2004, of 2.3% of GDP (see table 1).

(1) Assuming currently known policies.

4. CONCLUSIONS

The Dutch authorities have complied with the Council recommendation of 2 June 2004 issued under Article 104(7). Specifically, they have complied with the recommendation to put an end to the excessive deficit situation, in accordance with Article 3(4) of Regulation (EC) No 1467/97, which in the present case meant 2005 at the latest. In fact, they already reduced the deficit to 2.3% of GDP, well below the 3% threshold, in 2004. According to the Commission services' Spring 2005 forecast, under present policies the deficit is expected to decrease to 2.0% of GDP in 2005 in response to the further fiscal tightening contained in the 2005 budget and to fall further to 1.6% of GDP in 2006, indicating that the measures taken entail a durable correction of the budget deficit. The cyclically-adjusted balance improved markedly in 2004, by 0.8% of GDP, to a deficit of 1.2% of GDP. It is expected to fall by a further 0.8% of GDP and reach a position close to balance in 2005, which would be maintained in 2006. Finally, according to the March 2005 EDP notification, the debt ratio reached 55.2% of GDP in 2004, up from 54.3% of GDP in 2003; according to the Spring 2005 forecast, it is projected to remain below the 60% of GDP reference value in 2005 and 2006.

Hence, from an overall assessment it follows that the Dutch authorities completed already in 2004 the correction of the excessive deficit situation in 2004 under the terms of the Council Recommendation of 2 June 2004. Therefore, the Commission recommends the Council to abrogate the decision on the existence of an excessive deficit in the Netherlands.

Recommendation for a

COUNCIL DECISION

abrogating the decision of 2 June 2004 on the existence of an excessive deficit in the Netherlands

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(12) thereof,

Having regard to the recommendation from the Commission,

(1) By Council Decision 2005/136/EC of 2 June 2004[8] following a recommendation from the Commission in accordance with Article 104(6) of the Treaty, it was decided that an excessive deficit existed in the Netherlands.

(2) In accordance with Article 104(7) of the Treaty, the Council made a Recommendation addressed to the Netherlands with a view to bringing the excessive deficit situation to an end[9]. This Recommendation, in conjunction with Article 3(4) of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[10], established a deadline of 2005 at the latest for the correction of the excessive deficit.

(3) In accordance with Article 104(12) of the Treaty, a Council Decision on the existence of an excessive deficit is to be abrogated when the excessive deficit in the Member State concerned has, in the view of the Council, been corrected.

(4) The definitions of "government" and "deficit" are laid down in the Protocol on the excessive deficit procedure by reference to the European System of Integrated Economic Accounts (ESA), second edition. The data for the excessive deficit procedure are provided by the Commission.

(5) Based on the data provided by the Commission after reporting by the Netherlands before 1 March 2005 in accordance with Council Regulation (EC) No 3605/93 of 22 November 1993 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community[11], as amended by Council Regulation (EC) No 475/2000[12], on the subsequent reporting of revised general

---

8 Council Decision of 2 June 2004 (OJ L 47, 18.2.2005, p. 26).
9 Council Recommendation of 2 June 2004.
10 OJ L 209, 2.8.1997, p. 6.
11 OJ L 332, 31.12.1993, p. 7. Regulation as last amended by Commission Regulation (EC) No 351/2002 (OJ L 55, 26.2.2002, p. 23).
12 OJ L 58, 3.3.2000, p. 1.

government accounts to Eurostat on 31 March 2005, and on the Commission services' Spring 2005 forecast, the following conclusions are warranted:

– the general government deficit is estimated at 2.3% of GDP in 2004, compared with 3.2% in 2003. The outcome for 2004 is in compliance with the Council recommendation issued under Article 104(7), particularly as regards the reduction of the government deficit below the reference value of 3% of GDP by 2005 at the latest. Fiscal adjustment was pursued in 2004 in the form of substantial savings measures, partly contained in the 2004 budget and partly decided in additional consolidation package on 16 April 2004. Moreover, stronger-than-expected tax receipts and additional revenues from the sale of natural gas in response to high oil prices helped reduce the deficit;

– the budgetary measures taken are geared towards securing a lasting improvement in the general government balance. For 2005, the Commission services' Spring 2005 forecast projects a further decline in the general government deficit to 2.0% of GDP, largely in response to savings measures, mostly of a structural nature, adding up to 0.5% of GDP. This is in line with the official target of a deficit of 2.1% of GDP. For 2006, the Commission services' Spring 2005 forecast projects, based on currently known policies, a further fall in the deficit to 1.6% of GDP, pointing to the durable correction of the budget deficit;

– the budgetary consolidation will be sustained through a reduction in the cyclically adjusted deficit which is expected to reach close to balance after the excessive deficit has been corrected. In 2004, the cyclically adjusted deficit fell markedly to 1.2% of GDP, compared to 2.0% of GDP in 2003. The Commission services' Spring 2005 forecast projects the cyclically adjusted deficit to further decrease in 2005 by another 0.8% of GDP, to 0.4% of GDP, which is close to balance, and to fall to 0.0% of GDP in 2006;

– according to the March 2005 EDP notification, the government debt ratio was kept below the 60% of GDP reference value in 2004. The Commission services' Spring 2004 forecast projects it to remain below this threshold in 2005 and 2006.

(6) Decision 2005/136/EC should therefore be abrogated.

HAS ADOPTED THIS DECISION:

Article 1

From an overall assessment it follows that the correction of the excessive deficit situation in the Netherlands was completed in 2004, under the terms of the recommendation addressed to the Netherlands on 2 June 2004 in accordance with Article 104(7) of the Treaty.

Article 2

Decision 2005/136/EC is hereby abrogated.

Article 3

This Decision is addressed to the Kingdom of the Netherlands.

Done at Brussels,

For the Council
The President