COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 11.1.2005
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Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of the Netherlands, 2004-2007

(presented by the Commission)

EXPLANATORY MEMORANDUM

Council Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1] stipulates that participating Member States, that is, those which have adopted the single currency, had to submit stability programmes to the Council and the Commission by 1 March 1999. In accordance with Article 5 of this Regulation, the Council had to examine each stability programme based on assessments prepared by the Commission and the Committee set up by Article 114 of the Treaty (the Economic and Financial Committee). On the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee, the Council delivered an opinion, following its examination of the programme. According to the Regulation, Member States need to submit annual updates of their stability programmes, which may also be examined by the Council in accordance with these same procedures.

In view of a general government deficit of 3.2% of GDP recorded in 2003, the Council decided that the Netherlands were in excessive deficit on 2 June 2004 and recommended that the excessive deficit be corrected by 2005 at the latest. In particular, it was recommended that the corrective measures taken by 2005 should be mainly of a structural nature and amount to at least half a percentage point of GDP. In its meeting of 21 October 2004 the Ecofin Council reviewed the measures taken by the Netherlands and concluded, in line with the assessment of the Commission, that at that stage the measures appeared adequate to correct the excessive deficit by the required deadline. The Commission and the Council will continue to monitor the action taken. The assessment of the stability programme update is part of this continuous surveillance.

The first stability programme of the Netherlands, covering the period 1999-2002, was submitted on 4 November 1998 and assessed by the Council on 1 December 1998. Updates have been presented every subsequent year, the most recent one having been submitted on 23 November 2004. The Commission services have carried out a technical evaluation of this update, taking into account the results of their own autumn 2004 economic forecasts, and having regard to the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances, the recommendations in the broad economic policy guidelines for the period 2003-2005 and the principles laid down in the Communication from the Commission to the Council and the European Parliament of 27 November 2002 on strengthening the coordination of budgetary policies, endorsed by the Council[3]. This evaluation is as follows:

– The 2004 update of the stability programme of the Netherlands, which covers the period 2004-2007, was submitted on 23 November 2004, following its approval by the government. The multi-annual projections in the update are mainly derived from the 2005 budget, which was submitted to Parliament on 21 September 2004[4]. The update largely complies with the data requirements of the "code of conduct on the content and format of

1 OJ L 209, 2.8.1997. All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

2 Revised Opinion of the Economic and Financial Committee on the content and format of stability and convergence programmes, endorsed by the ECOFIN Council on 10.7.2001.

3 COM(2002) 668 final, 27.11.2002.

4 The 2005 budget was adopted by Parliament with a number of amendments that did not have an appreciable impact on the main budgetary aggregates.

stability and convergence programmes". It covers all the areas required and provides all the compulsory variables requested, and most of the optional ones except certain data concerning potential output.

- The macroeconomic scenario in the update is taken from the CPB Netherlands Bureau of Economic Policy Analysis (CPB). The update assumes a gradual recovery, with real GDP growth at 1½% in 2005, picking up to 2½% from 2006 onwards. For the period 2004-2006, the projections of key variables are quite close to those in the Commission services' autumn 2004 forecast. However, the latest available data on commodity prices, exchange rates and trade volumes suggest that macroeconomic scenario in the update for the years 2005 and 2006 is on the optimistic side. The assumptions on economic growth in 2005 in particular seem favourable. The growth assumptions for 2007 seem plausible in view of the estimated rate of potential growth and the expectation that the negative output gap would be reduced gradually during the upturn. The rates of potential growth and of the output gap derived from the update's macroeconomic scenario using the agreed methodology appear to be plausible. The programme's projections for inflation appear realistic.

- The primary aim of the update's budgetary strategy is to bring the general government deficit below the Treaty reference value of 3% of GDP by 2005. To this end, it encompasses a frontloaded consolidation effort, concentrated in 2004 and 2005. The corrective measures for 2005 add up to half a percentage point of GDP. With the combined effect of fiscal consolidation and the expected gradual economic upturn, the update projects the general government deficit to fall from 3.0% of GDP in 2004 to 2.6% of GDP in 2005, 2.1% of GDP in 2006 and 1.9% of GDP in 2007. The cyclically-adjusted deficit is expected to be lower throughout the time horizon covered and to decrease from 1.6% of GDP in 2004 to 1.2% of GDP in 2005. However, the cyclically-adjusted balance is not expected to improve further in 2006 and would even deteriorate slightly in 2007, to a deficit of 1.3% of GDP. The budgetary strategy entails the use of real expenditure ceilings to control expenditure growth and the longer-term objective of sustainable public finances, in line with the strategy of the previous update. The public investment ratio is expected to remain constant over the period covered, at slightly above 3% of GDP, against an EU average of 2.4% of GDP in 2004.

- The budgetary forecasts of the update appear plausible and the uncertainties to the projections are broadly balanced. Some risks to the deficit projections stem from the risks to the macroeconomic outlook. Moreover, the budgetary costs of the social agreement reached between the government and social partners on 5 November 2004 have not been incorporated in the update, while the uncertainty surrounding the implementation of reforms in the areas of health care and pensions might also lead to a higher deficit. However, these risks are mitigated by the positive impact of higher oil prices on receipts from the sale of natural gas, and by the fact that the assumptions on the tax intensity of economic activity used in the baseline scenario of the update are on the cautious side. Taking into account the balance of risks to the budgetary targets, the Netherlands appear to be on track to correct its excessive deficit by 2005, the deadline set by the Council. However, the fiscal consolidation path foreseen after the correction of the excessive deficit lacks ambition, as it would not ensure the achievement of the medium-term objective of a budgetary position of close-to-balance within the programme period. Moreover, in this period (2006-2007), the budgetary stance in the update does not seem to provide a sufficient safety margin against normal macroeconomic fluctuations breaching the 3%-of-GDP threshold.

– The update expects the debt ratio to remain below the 60%-of-GDP reference value and to rise from slightly over 56% of GDP in 2004 to somewhat above 58% of GDP in each of the years 2005 to 2007, with the pick-up in nominal GDP growth largely offsetting the upward impact of persistent deficits on the debt ratio. The update expects the stock-flow adjustments to contribute slightly to increases in debt in the period 2005-2007 after debt-reducing stock-flow adjustments in the period 2000-2003 due to privatisation receipts; the size of the adjustments, however, would remain relatively limited at less than half a percentage point of GDP. These projections are quite close to the Commission services' autumn 2004 forecast. Risks to the debt ratio correspond to those for the deficit projections and appear broadly balanced.

– The update briefly reviews the government's structural reform programme, which encompasses a far-reaching overhaul of the social security, pension and health care systems that is intended to improve the sustainability of public finances and to increase labour participation. It also outlines the positive impact on employment and economic activity of a reduction in the administrative burden. On balance, the reforms should help improve the sustainability of Dutch public finances. However, in several areas, such as health and pension reform, there is some doubt as to how effectively the proposed measures will influence the actual behaviour of economic agents and thus secure the intended budgetary savings. Moreover, it seems that the positive budgetary impact of structural reforms which strengthen potential growth will be felt mainly after the period covered by the update, while some of the measures that boost net revenue in the near term may not be optimal in terms of improving the structure of the economy, for instance the increase in the marginal wedge for low-to-medium incomes.

– The Netherlands are in a relatively favourable position with regard to the long-term sustainability of public finances, in spite of important projected budgetary cost of an ageing population. However, despite ongoing reforms in the areas of social security, pensions and health care, its current policies do carry some sustainability risks. The strategy outlined in the programme is mainly based on measures aimed at raising labour force participation and at containing age-related expenditures. Given the projected increase in the old-age dependency ratio, further reforms that would modify the trends in age-related expenditures and raise further participation rates are a key factor in ensuring sustainability over the longer-term.

– Overall, the economic policies outlined in the update are partly consistent with the country-specific broad economic policy guidelines in the area of public finances. The budgetary framework with expenditure ceilings is adhered to, and budgetary adjustment to correct the excessive deficit is well under way. However, the expected reduction in the headline deficit in 2006 and especially 2007 is quite slow, and the cyclically-adjusted balance would not be reduced by at least 0.5 percent of GDP in each year. Moreover, the attainment of a fiscal position close to balance or in surplus is not anticipated within the time span covered by the update.

– In view of the above assessment, the Netherlands are recommended to take the necessary measures to ensure that a budgetary position close to balance is achieved and maintained after the correction of the excessive deficit.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007
Real GDP (% change)	**SP Nov. 2004**	**1¼**	**1½**	**2½**	**2½**
	COM	1.4	1.7	2.4	n.a.
	SP Oct. 2003	*1*	*2½*	*2½*	*2½*
HICP inflation (%)	**SP Nov. 2004**	**1¼**	**1¼**	**1½**	**1½**
	COM	1.2	1.3	1.4	n.a.
	SP Oct. 2003	*1.5*	*1½*	*1½*	*1½*
General government balance (% of GDP)	**SP Nov. 2004**	**-3.0**	**-2.6**	**-2.1**	**-1.9**
	COM	-2.9	-2.4	-2.1	n.a.
	SP Oct. 2003	*-2.3*	*-1.6*	*-0.9*	*-0.6*
Primary balance (% of GDP)	**SP Nov. 2004**	**-0.1**	**0.3**	**0.7**	**0.8**
	COM	0.0	½	0.9	n.a.
	SP Oct. 2003	*0.6*	*1.2*	*1.8*	*2.1*
Cyclically-adjusted balance (% of GDP)	**SP Nov. 2004**[1]	**-1.6**	**-1.2**	**-1.2**	**-1.3**
	COM	-1.4	-1.0	-1.0	n.a.
	SP Oct. 2003[1]	-0.7	-0.3	-0.2	-0.2
Government gross debt (% of GDP)	**SP Nov. 2004**	**56.3**	**58.1**	**58.6**	**58.3**
	COM	55.7	58	58.4	n.a.
	SP Oct. 2003	*54. 5*	*53.7*	*53.0*	*52.2*

[1]Commission services' calculations on the basis of the information in the programme.

Sources:
Stability programmes (SP); Commission services' autumn 2004 economic forecasts (COM); Commission services' calculations. Forecast growth rates in the update have been rounded to the nearest quarter of a percentage point.

On the basis of this assessment, the Commission has adopted the attached recommendation for a Council Opinion on the updated stability programme of the Netherlands and is forwarding it to the Council.

Recommendation for a

COUNCIL OPINION

in accordance with the third paragraph of Art. 5 of Council Regulation (EC) No 1466/97 of 7 July 1997

On the updated stability programme of the Netherlands, 2004-2007

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[5], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [18 January] 2005 the Council examined the updated stability programme of the Netherlands, which covers the period 2004 to 2007. The programme largely complies with the data requirements of the revised "code of conduct on the content and format of stability and convergence programmes".

(2) The macroeconomic scenario underlying the programme envisages that real GDP growth will pick up from 1% in 2004 to 1½% in 2005 and 2½% on average over the rest of the programme period. This scenario seems to reflect rather favourable growth assumptions in view of recent trends in commodity prices, exchange rates and relevant trade volumes. The programme's projections for inflation appear realistic.

(3) On 2 June 2004, the Council decided that an excessive deficit existed in the Netherlands and recommended that this be corrected by 2005. In line with this recommendation, the primary aim of the budgetary strategy of the programme is to bring the general government deficit below the Treaty reference value of 3% of GDP by 2005. To this end, the programme encompasses a frontloaded consolidation effort, concentrated in 2004 and 2005. The budgetary strategy also includes the use of real expenditure ceilings to control expenditure growth and the longer-term objective of sustainable public finances. At the same time, significant public investments will continue, resulting in an average public investment ratio over the programme period of slightly above 3% of GDP, against an EU average of 2.4% of GDP in 2004.

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5 OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm.

(4) The risks to the budgetary projections in the programme appear broadly balanced. In particular, negative risks stemming from the macroeconomic scenario and the budgetary cost of the social agreement between the government and social partners reached on 5 November 2004 are broadly offset by positive risks of the impact of higher oil prices on revenue from the sale of natural gas and the cautious nature of the assumptions on the tax intensity of economic activity in the upturn. In view of this risk assessment, the budgetary stance in the programme seems sufficient to reduce the deficit to below 3% of GDP by 2005 but does not seem to provide a sufficient safety margin against breaching this threshold as a result of normal macroeconomic fluctuations in the following years. It also seems insufficient to ensure that the Stability and Growth Pact's medium-term objective of a budgetary position of close to balance is achieved within the programme period.

(5) The debt ratio is estimated to have reached 56.3% of GDP in 2004, below the 60% of GDP Treaty reference value. The programme projects the debt ratio to increase by two percentage points over the programme period.

(6) The budgetary strategy outlined in the programme puts the Netherlands in a relatively favourable position with regard to the long-term sustainability of public finances, despite important projected budgetary costs of an ageing population. Given the projected increase in the old-age dependency ratio, and in the absence of further fiscal consolidation leading to a budgetary position close to balance or in surplus in the medium term, further reforms that would modify the trends in age-related expenditures and raising further participation rates would reduce sustainability risks over the longer term.

(7) The economic policies outlined in the programme are partly consistent with the country-specific broad economic policy guidelines in the area of public finances. The budgetary framework with expenditure ceilings is adhered to, and budgetary adjustment to correct the excessive deficit is well under way. However, the expected reduction in the headline deficit in 2006 and especially 2007 is quite slow, while the cyclically-adjusted balance would not show progress towards the medium-term objective of a budgetary position of close-to-balance after 2005.

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In view of the above assessment, the Netherlands are recommended to continue to ensure that the deficit is brought below 3% of GDP by 2005, and to take the necessary measures to achieve a budgetary position close to balance thereafter.

Key projections from the updated stability programme of the Netherlands

	2003	2004	2005	2006	2007
Real GDP growth (%)	-0.9	1¼	1½	2½	2½
HICP inflation (%)	2.2	1¼	1¼	1½	1½
General government balance (% of GDP)	-3.2	-3.0	-2.6	-2.1	-1.9
Primary balance (% of GDP)	-0.3	-0.1	0.3	0.7	0.8
Cyclically-adjusted balance (% of GDP)[1]	-1.9	-1.6	-1.2	-1.2	-1.3
Government gross debt (% of GDP)	54.1	56.3	58.1	58.6	58.3

[1] Commission services' calculations applying the commonly agreed methodology to the information in the programme.