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DECEMBER 2005 UPDATE OF THE STABILITY PROGRAMME OF THE NETHERLANDS (2005-2008)

AN ASSESSMENT

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SUMMARY AND CONCLUSIONS[1]

The December 2005 update of the Dutch stability programme, covering the period 2005 to 2008, was submitted to the Council and Commission on 22 December 2005; i.e., three weeks after the deadline of 1 December as prescribed in the code of conduct. According to the authorities, the late submission was caused by their wish to include new economic projections and possible supplementary policies. The programme broadly follows the model structure and data provision requirements for stability and convergence programmes specified in the new code of conduct.[2]

In its opinion of 18 January 2005 on the previous update of the stability programme, covering the period 2004-2007, the Council invited the Netherlands to ensure that the deficit was brought below 3% of GDP by 2005, and, in view of the risk of pro-cyclicality and the challenges of ageing population, to take the necessary measures to achieve a budgetary position close to balance thereafter.

After buoyant economic growth in the second half of the 1990s, with GDP growth averaging 3¾% per year also supported by a booming housing market and rising stock prices, growth came to a standstill in the years 2002 and 2003 and again in early 2005. Following a comfortable surplus in 2000, the general government balance deteriorated sharply turning into a deficit in 2001 and 2002 and exceeding the 3% of GDP threshold in 2003. On 2 June 2004 the Council decided that the Netherlands were in excessive deficit and recommended that the excessive deficit be corrected by 2005. A substantial budgetary consolidation was achieved already in 2004, which reduced the deficit to 2.1% of GDP in 2004. On 7 June 2005, the Council decided that the excessive deficit in the Netherlands had been corrected in 2004 and therefore abrogated the excessive deficit decision.

The programme projects real GDP growth to increase from an estimated ¾% in 2005 to 2½% in both 2006 and 2007, before slowing to 2¼% in 2008. The projected pick-up in growth is driven by a recovery in both domestic demand and exports. The economic growth projections and the implied gradual decrease of the negative output gap are plausible, also in view of recent positive economic data. Inflation is expected to stabilise at 1.5% in 2006, before falling to just above 1% in 2007, which seems favourable also compared to the Commission services' autumn 2005 forecast. This reflects the lower oil price assumption, especially in 2007 and thereafter.

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1 This technical analysis, which is based on information available up to 14 February 2006, accompanies the recommendation by the Commission for a Council opinion on the update of the stability programme, which the College adopted on 22 February, 2006. It has been carried out by the staff of and under the responsibility of the Directorate-General for Economic and Financial Affairs of the European Commission. Comments should be sent to Bouke Buitenkamp (bouke.buitenkamp@cec.eu.int). The analysis takes into account (i) the Commission services' autumn 2005 forecast, (ii) the code of conduct ("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), (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances and (iv) the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.

2 Some chapters are missing or are incomplete. Compulsory data regarding the basic assumptions were missing in the programme, but were subsequently supplied by the Dutch authorities. An important part of optional data prescribed by the new code of conduct is missing.

As regards budgetary implementation in 2005, the December 2005 update estimates that the general government deficit fell to 1.2% of GDP against a deficit target of 2.6% of GDP set in the November 2004 update of the stability programme and a deficit projection of 1.8% of GDP in the Commission services' autumn 2005 forecast. The largest part of the improvement can be attributed to better-than-expected revenues mainly from higher gas prices and higher dividend, VAT and corporate tax revenues. According to most recent government estimates presented to Parliament, the 2005 deficit is even likely to be near ¾% of GDP, substantially lower than projected in the programme update.

The authorities' main strategic objective is to achieve sound public finances to support sustainable economic growth and absorb the costs of ageing. After the substantial consolidation achieved in 2004 and 2005, the 2005 update of the stability programme projects the general government deficit to increase to 1.5% in 2006 and subsequently to stabilise at around 1.1% of GDP. Both total expenditure- and revenue-to-GDP ratios are expected to increase by about 1% but this appears to be merely a reflection of the reform of the health insurance system resulting in higher social transfers as well as health insurance contributions. Compared with the previous programme which foresaw a continued deficit reduction from an expected 2.6% of GDP in 2005, the new update takes into account the better-than-expected deficit outcome of 1.2% of GDP in 2005 and foresees a broad stabilisation at this level (except for a deterioration in 2006) against the background of a comparable macroeconomic scenario from 2006 onwards.

Based on Commission services' calculations on the basis of the programme according to the commonly agreed methodology, the structural balance improved markedly from -2¼% of GDP in 2003 to a balanced position in 2005. This reflects the strong adjustment effort of over 1 percentage point of GDP per year on average after the excessive deficit occurred in 2003, even without taking into account the fact that the budgetary outcome in 2005 may be better than assumed in the programme. Based on these same calculations, the structural balance would deteriorate from a balanced position in 2005 to a deficit of nearly ¾% of GDP in 2006 against a diminishing although still negative output gap. Half of this structural change reflects the fact that companies paid higher-than-expected tax advances to take advantage from above-market interest rates paid by the Government, with an expected mirror effect in 2006. Thereafter the deficit stabilises at slightly above half a percentage point of GDP. The programme identifies the medium-term objective (hereafter MTO) for the budgetary position as meant in the Stability and Growth Pact of a structural (i.e. cyclically-adjusted and net of one-off or other temporary measures) budget balance between -0.5% and -1% of GDP. This MTO is at an appropriate level because it lies within the range indicated for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct and adequately reflects the debt ratio and average potential output growth in the long term. Despite the expected fiscal deterioration in 2006, the structural deficit is projected to remain within the MTO-range as set in the programme.

The risks to the budgetary projections in the programme's baseline scenario for 2006 and beyond appear broadly balanced and budgetary outcomes could be somewhat better than projected beyond 2006. As far as 2006 is concerned, current indicators suggest a strong pick-up in economic activity from the second half of 2005 onwards, compared with the Commission services' autumn 2005 forecast. Moreover, according to the latest available information, the 2005 deficit is now expected to be substantially lower than projected in the programme update. However, due to the lack of details on the likely (non)recurrence of higher revenues and lower expenditures compared to the programme baseline, an assessment of the carry-over effects of the better-than-expected 2005 outturn into 2006 and beyond is difficult to provide; it can also not be totally excluded that some of the better-than-expected outcome in 2005 may have negative carry-over effects. Beyond 2006, there exists a positive risk to the programme's budgetary projection if the oil price turns out higher than anticipated in the programme as receipts from the sales of gas are linked to that of oil. On the other hand, it is not yet clear whether the expected budgetary savings from the reforms in the health and social security systems that came into force at the beginning of 2006 will be fully achieved as the behavioural effects of the reforms cannot yet be assessed with accuracy; the programme does not provide details on their budgetary implications as required by the Code of Conduct.

Taking into account the risk assessment above, the budgetary strategy outlined in the programme seems sufficient to ensure that the programme's MTO is maintained throughout the programme period. The projected structural balance in every year falls within the MTO-range as specified in the programme and is better than the minimum benchmark of a structural deficit of around 1% of GDP, which ensures a sufficient margin against breaching the 3% of GDP threshold in case of adverse cyclical developments. Nevertheless, despite the strong economic recovery, there is a deterioration of ¾% of GDP in the structural balance in 2006 although this is partly due to exceptional factors. If the positive outcome in 2005 is confirmed, the fiscal deterioration implied by the 2006 target could even be larger, unless the authorities take measures to contain it.

The programme projects the government debt to broadly stabilise in 2006 at 54.5% of GDP before gradually decreasing to around 53% in 2008. These projections are very close to those of the Commission services. Risks to the debt forecasts primarily stem from the risks to the deficit projections, which, as stated above, appear broadly balanced.

With regard to the sustainability of public finances, the Netherlands appears to be at low risk on grounds of the projected budgetary costs of ageing populations. The current level of debt is under the Treaty value of 60% of GDP and the recent improvement of the budgetary situation in the Netherlands has helped alleviate risks to long-term sustainability. The implementation of recent reforms of the disability scheme will also contribute to curb long-term public spending. However, even fully taken into account, the projected future rise in revenue, notably due to delayed taxation of pension may not be sufficient to compensate totally the rise in public expenditure over the long-term. Further budgetary consolidation may therefore be necessary to fully offset the impact of ageing.

The envisaged measures in the area of public finances are broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008. In particular they are in line with the integrated guideline on securing economic stability by maintaining the medium-term budgetary objective over the economic cycle. The programme also complies with the integrated guideline on safeguarding economic sustainability in view of the projected costs of ageing population.

The National Reform Programme of the Netherlands, submitted on October 14, 2005 in the context of the renewed Lisbon strategy for growth and jobs, identifies improving labour supply; faster growth in labour productivity through strengthening R&D and innovation; and improving price competitiveness through containing labour costs as challenges. Of these, strengthening R&D and innovation are expected to have significant implications for public finances. However, given limited information especially on the timing of the structural reforms in these areas, it is difficult to ascertain whether the actions outlined in the National Reform Programme are fully reflected in the budgetary projections of the stability programme. The measures in the area of public finances envisaged in the stability programme seem to be broadly in line with the actions foreseen in the National Reform Programme.

In view of the above assessment, it should be welcomed that the Dutch Government made efforts to bring the deficit further below the 3 % of GDP reference value in 2005, after the prompt correction of the excessive deficit, and that it plans to respect the medium-term objective throughout the programme period. Also in view of better-than-expected results in 2005, it would be appropriate for the Netherlands to ensure that the strong budgetary position is maintained in 2006 and thereafter.

Comparison of key macroeconomic and budgetary projections

		2004	**2005**	**2006**	**2007**	**2008**
Real GDP (% change)	**SP Dec 2005**	**1.7**	**¾**	**2 ½**	**2 ½**	**2 ¼**
	COM Nov 2005	1.7	0.5	2.0	2.4	n.a.
	SP Nov 2004	*1 ¼*	*1 ½*	*2 ½*	*2 ½*	*n.a.*
HICP inflation (%)	**SP Dec 2005**	**1.4**	**1.5**	**1.5**	**1.1**	n.a.
	COM Nov 2005	1.4	1.7	2.0	1.9	n.a.
	SP Nov 2004	*1¼*	*1¼*	*1½*	*1½*	*n.a.*
Output gap (% of potential GDP)	**SP Dec 2005**[1]	**-1.5**	**-2.3**	**-1.5**	**-1.1**	**-0.9**
	COM Nov 2005[3]	-1.3	-2.2	-1.9	**-1.4**	n.a.
	SP Nov 2004	*-2.1*	*-2.2*	*-1.5*	*-0.9*	*n.a.*
General government balance (% of GDP)	**SP Dec 2005**	**-2.1**	**-1.2**	**-1.5**	**-1.2**	**-1.1**
	COM Nov 2005	-2.1	-1.8	-1.9	-1.5	n.a.
	SP Nov 2004	*-3.0*	*-2.6*	*-2.1*	*-1.9*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2005**	**0.6**	**1.4**	**1.1**	**1.4**	**1.5**
	COM Nov 2005	0.5	0.7	0.6	1.0	n.a.
	SP Nov 2004	*-0.1*	*0.3*	*0.7*	*0.8*	*n.a.*
Cyclically-adjusted balance = Structural balance[2] (% of GDP)	**SP Dec 2005**[1]	**-1.3**	**0.0**	**-0.7**	**-0.6**	**-0.6**
	COM Nov 2005	-1.4	-0.6	-0.8	-0.7	n.a.
	SP Nov 2004	*-1.6*	*-1.2*	*-1.2*	*-1.3*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2005**	**53.1**	**54.4**	**54.5**	**53.9**	**53.1**
	COM Nov 2005	53.1	54.0	54.2	53.8	n.a.
	SP Nov 2004	*56.3*	*58.1*	*58.6*	*58.3*	*n.a.*

Notes:
[1]Commission services' calculations on the basis of the information in the programme (until 2007).
[2] As there are no one-off and other temporary measures in the programme, the cyclically-adjusted balance and the structural balance are identical.
[3]Based on estimated potential growth of 1.5%, 1.6%, 1.7% and 1.8% respectively in the period 2004-2007.
Source:
Stability programme (SP); Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations.

1. INTRODUCTION

The December 2005 update of the Dutch stability programme, covering the period 2005 to 2008, was submitted to the Commission on 22 December 2005[3]. According to the Dutch authorities, the reason for the late submission was the willingness to include new economic projections and incorporate possible supplementary policies. The programme has been agreed upon by the council of ministers and sent to parliament for information.

The programme broadly follows the model structure and data provision requirements for stability and convergence programmes specified in the new code of conduct. However, the chapter on the overall policy framework and objectives is missing, the chapter on the quality of public finances contains none of the requested sections, and some sections of other chapters are missing (e.g. sectoral balances and the budgetary implications of "major structural reforms"). Compulsory data regarding the basic assumptions were missing in the programme, but were subsequently supplied by the Dutch authorities. An important part of optional data suggested by the new code of conduct is missing, in particular the breakdown of government receipts for 2007 and 2008.[4] Annex 2 provides a detailed overview of all aspects of compliance with the new code of conduct.

2. ECONOMIC OUTLOOK

The Dutch economy grew buoyantly during the second half of the 1990s, averaging 3¾% per year and thereby outpacing EU25 growth by one percentage point. Similarly, employment growth was much stronger than in neighbouring countries and registered unemployment fell to a record 2.2% in 2001[5]. Growth was largely driven by domestic demand, which benefited from temporary factors such as the booming housing market and rising stock prices. As the housing market cooled from 2001 onwards and stock markets declined, the lack of stimuli resulted in faltering economic growth. For the years 2002 and 2003 combined, economic growth was zero. It is only in early 2004 that the Dutch economy recovered hesitantly, mainly on the back of strong growth in international trade, while private consumption remained sluggish. In 2005, high oil prices and the slowdown in international trade growth resulted in a fall in economic growth. Inflation remained relatively subdued during the late 1990s and 2000, averaging 1.9%, but caught up in 2001 and 2002, when the economy was already coming to a halt. HICP in those years reached 5.1% and 3.9%, respectively. Contractual wages followed a similar path, showing increases of 4.2% and 3.5% in 2001 and 2002. Since 2003,

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[3] The English version was submitted on 10 January 2006.

[4] Missing optional data are: HICP 2008 (table 1a), Labour productivity hours worked (table 1c), specification of net lending/borrowing into balance on goods and services, primary incomes and transfers and capital account and statistical discrepancies 2005 to 2008 (table 1d), components of government revenue for 2007 and 2008 (table 2, lines 11a to 15) and social transfers in kind/ other than in kind (table 2, lines 17a + b,), general government expenditure by function (table 3, missing entirely), breakdown of Stock flow adjustment missing, as well as liquid financial assets net financial debt (table 4), long term sustainability (table 7, missing entirely).

[5] However, there is a large hidden unemployment component among the beneficiaries of the disability scheme.

inflation and wage growth have come down significantly to reach 1.5% and 1%, respectively, in 2005.

According to the programme's macroeconomic scenario, real GDP growth is expected to increase from an estimated ¾% in 2005 to 2½% in both 2006 and 2007 before slowing down somewhat to 2¼% in 2008 (see Table 1). The main factor behind this acceleration would be the recovery in domestic demand, whose contribution to GDP growth is projected to increase from ½% in 2005 to 2% in 2006 before declining somewhat to 1½% in the outer years of the programme. Private consumption is projected to progressively recover after three years of sluggishness (a cumulative 1.4% decline from 2002 to 2005)[6], while investment should reaccelerate after the slowdown recorded in 2005. The contribution of net exports to GDP growth should increase more modestly, from ½% in 2005 and 2006 to 1% in 2007 and ¾% in 2008, because imports should increase nearly as fast as exports over the period due to the recovery in domestic demand. After nearly five years of sluggish growth (with only a failed recovery in 2004), the output gap is estimated to be widely negative (-2.3% in 2005 according to calculations by the Commission services on the basis of the commonly agreed methodology and using the information provided by the programme). However, it is expected to progressively narrow to -0.6% in 2008.

Table 1: Comparison of macroeconomic developments and forecasts

	2005		**2006**		**2007**		**2008**
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**
Real GDP (% change)	0.5	¾	2.0	2 ½	2.4	2 ½	2 ¼
Contributions:							
- Final domestic demand	0.2	½	1.7	2.0	2.9	1 ½	1 ½
- Change in inventories	-0.2	-¼	0.0	0	-0.1	0	0
- External balance on g&s	0.5	½	0.3	½	-0.4	1.0	¾
Output gap[1]	-2.2	-2.3	-1.9	-1.5	-1.4	-0.9	-0.6
Employment (% change)	-0.6	-¼	0.5	1 ½	1.0	1 ¾	1 ¾
Unemployment rate (%)	5.1	4.7	4.9	4.2	4.2	3.8	3.4
Labour productivity growth (%)	1.1	1 ¼	1.5	1 ½	1.4	1 ½	1 ½
HICP inflation (%)	1.7	1.5	2.0	1.5	1.9	1.1	n.a.
GDP deflator (% change)	0.9	1 ¼	0.9	1.0	1.6	1.0	1.0
Compensation of employees (% change)	0.8	1 ¼	1.5	2 ¼	2.3	2 ½	2 ½
External balance (% of GDP)	**7.4**	**6.4**	**6.8**	**6.1**	**6.2**	**n.a.**	**n.a.**

Note:
[1]In percent of potential GDP, with potential GDP growth as reported in Table 2 below.

Source:
Commission services' autumn 2005 economic forecasts (COM); stability programme update (SP)

Regarding the external assumptions, it is noteworthy that the programme's macroeconomic scenario projects the oil price to decline from the USD 50 forecast for 2006 to USD 26 both in 2007 and 2008[7] which, though not impossible, seems at the moment unlikely. Moreover, this assumption is not consistent with the rest of the

6 It is projected to grow by 1% in 2006, 1¾% in 2007 and 2% in 2008. The 2006 growth figure is corrected in order to exclude the effects of the reform of the health insurance. Without this correction, private consumption is forecast to drop by 2% in real terms in 2006.

7 This projection does not come from the September 2005 macroeconomic forecasts of the Centraal Planbureau (CPB), which do not cover 2007 and 2008.

macroeconomic scenario. If, as discussed below (see also footnote 10), a USD 15 difference (USD 65 per barrel instead of 50) in the oil price in 2006 results, according to estimates of the Netherlands Bureau for Economic Policy Analysis (*Centraal Planbureau* - CPB), in a 0.6% lower real GDP growth in the same year, a fall from USD 50 to 26, should probably, ceteris paribus, raise GDP growth by at least 1%, even if the effects of increases and decreases in oil prices are not perfectly symmetric. Similarly, such a fall in oil prices would probably engineer a bigger decline in inflation in 2007 than projected by the programme. Actually, the programme's macroeconomic projections seem more consistent with a stable or slightly declining oil price in 2007.

Overall, the programme's macroeconomic scenario appears to be based on plausible growth assumptions. They might appear somewhat more optimistic than the Commission services' autumn 2005 forecasts[8], which project real GDP growth at 2.0% in 2006 and 2.4% in 2007. The reasons for the difference are twofold: first, the Commission services' forecasts were based on the assumption that the oil price would average USD 61.4 per barrel in 2006 and USD 60.3 in 2007, while the forecasts of the CPB[9], on which the macroeconomic scenario of the programme is based, assumed it to decline to USD 50 per barrel in 2006[10]. Secondly, the more optimistic character of the programme's projections is in line with recent positive economic data. In particular, the first estimate of third quarter growth in 2005, which was released after the Commission services' forecast was finalised, came out at 0.6% quarter-on-quarter. For 2007, the real GDP growth projection of the programme (2½%) is very similar to the Commission services' forecast (2.4%). For 2007 and 2008 (the latter year is not covered in the 2005 autumn forecasts), the programme's GDP growth projections are broadly in line with the Commission services' estimates of potential growth for 2007, which amounts to 1¾%.

The programme's projections for private consumption growth, which is the tax base for indirect taxes, are slightly more optimistic than the Commission services' forecasts for 2006 (-2% as against -3%)[11] but they are very close for 2007 (+1¾% compared to +1.8%). For wages and salaries, which are the tax base for personal income tax and social contributions, the programme projects a faster growth than the Commission services' autumn forecasts for 2006 (+2¼% compared to 1.5%), but for 2007 the two projections are very similar (+2½% in the programme, +2.3% in the Commission services' forecasts).

Employment declined for three consecutive years in persons and for four consecutive years in full-time equivalent. The programme foresees employment to recover from 2006 onwards and to grow by about 1% to 1¼% a year throughout the period. This is

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8 Note that GDP projections in the Stability Programme are based on GDP including Financial Intermediation Services Indirectly Measured (FISIM), while the Commission services' autumn forecast projects GDP excluding FISIM.

9 Centraal Planbureau (CPB), *Macroeconomische Verkenning 2006*, September 2005.

10 The CPB forecasts present an "uncertainty variant", which is also included in the programme, and where in 2006 the oil price rises to USD 65 on average (15 USD higher) and real GDP growth is 0.6% lower than in the central scenario, which is very close to the Commission services forecasts.

11 These figures are strongly influenced by the introduction of the new health-care system that came into effect in 2006. This reform introduced a mandatory public health insurance scheme for everyone, thus collectivising part of the existing private health insurance arrangements. Therefore, part of the outlays on health-care is now counted as government consumption. The consumption figures for 2006 are around 3.7% lower as a result.

significantly higher than the Commission services' forecasts for 2006 (+0.5%), reflecting the more optimistic GDP growth projection of the programme for this year, while the implied increase in productivity is quite similar (1¼% in the programme, 1.5% in the Commissions services forecasts). For 2007, in line with the closeness of the growth projections, employment growth projections are also rather close (+1¼% in the programme, +1% in the forecast).

The programme foresees inflation as measured by Eurostat (HICP) to stabilise at 1.5% in 2006, the same rate as in 2005, and to slow down to 1.1% in 2007. This is favourable and significantly less than the inflation rate forecast by the Commission services (+2.0% in 2006, +1.9% in 2007), the main reason for this difference being the different assumptions on oil price developments. In the "uncertainty variant" of the forecast of the Netherlands Bureau for Economic Policy Analysis (see footnote 10), where oil price is assumed to rise to USD 65 per barrel in 2006 instead of declining to USD 50, inflation is 0.8% higher in 2006 than in the central scenario. This is, once again, very close to the Commission services' forecast.

Potential GDP growth (as calculated by Commission services according to the commonly agreed methodology, based on the information provided in the programme) is projected to progressively increase over the period from 1.6% in 2005 to 2.1% in 2008. These projections are very close to those implied by the Commission services' autumn 2005 forecasts, where potential GDP growth accelerates from 1.5% in 2005 to 1.9% in 2007 (the Commission services' forecasts do not yet cover 2008).

Table 2: Sources of potential output growth

	2005		**2006**		**2007**		**2008**
	COM	**SP[2]**	**COM**	**SP[2]**	**COM**	**SP[2]**	**SP[2]**
Potential GDP growth[1]	1.5	1.6	1.6	1.7	1.9	1.8	2.1
Contributions:							
- Labour	0.2	0.6	0.3	0.6	0.4	0.7	0.9
- Capital accumulation	0.5	0.5	0.6	0.6	0.7	0.7	0.7
- TFP	0.8	0.5	0.8	0.5	0.8	0.4	0.5

Notes:
[1]based on the production function method for calculating potential output growth
[2]Commission services' calculations on the basis of the information in the programme

Source:
Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations

3. GENERAL GOVERNMENT BALANCE

This section is in four parts. The first briefly compares the targets for the general government balance in the new update with those presented in previous stability programmes. It also discusses budgetary implementation in the year 2005. The second part describes the budgetary strategy in the new update, including the programme's medium-term objective. The third provides the analysis of the risks attached to the budgetary targets and assesses the country's position in relation to the budgetary objectives of the Treaty and the Stability and Growth Pact. The final part discusses the results of a sensitivity analysis.

3.1. Targets in successive programmes and implementation in 2005

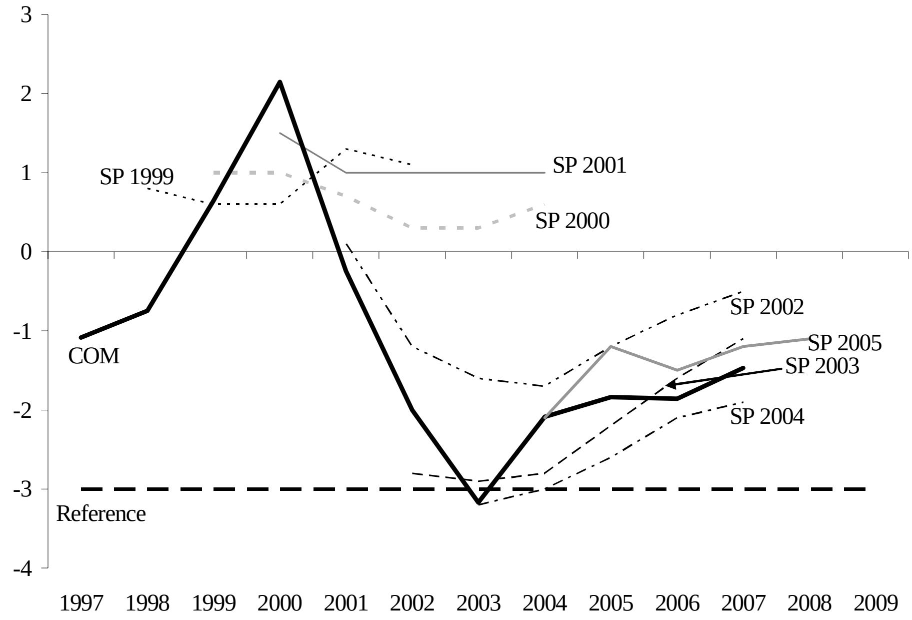
The December 2005 update of the Stability Programme expects the general government deficit to stabilise at around 1.2% of GDP, except for a deterioration in 2006 to 1.5%. Figure 1 and Table 3 provide an overview of the envisaged adjustment path for the general government balance in the update, as compared to previous programmes. As shown in Table 3, budgetary outcomes in this update are projected to be substantially better than anticipated in the November 2004 update which, starting from a considerably higher deficit in 2005, foresaw a continuous reduction in the deficit. The 2003 update also started from a somewhat higher 2005 deficit level than the current update, but it projected a continuous decline in 2006 and 2007, reaching a deficit of 0.6% of GDP in the latter year, compared to a stabilisation at around 1.2% of GDP in this update.

Table 3: Evolution of budgetary targets in successive programmes

		2004	2005	2006	2007	2008
General government balance (% of GDP)	**SP December 2005**	**-2.1**	**-1.2**	**-1.5**	**-1.2**	**-1.1**
	SP November 2004	-3.0	-2.6	-2.1	-1.9	n.a.
	SP October 2003	-2.3	-1.6	-0.9	-0.6	*n.a.*
	COM Nov 2005	-2.1	-1.8	-1.9	-1.5	n.a.
General government expenditure (% of GDP)	**SP December 2005**	**47.1**	**47.2**	**48.8**	**48.1**	**48.1**
	SP November 2004	48.0	47.5	46.7	46.0	n.a.
	SP October 2003	47.4	46.3	45.7	45.2	n.a.
	COM Nov 2005	47.1	48.8	49.5	49.5	n.a.
General government revenues (% of GDP)	**SP December 2005**	**45.0**	**46.0**	**47.3**	**46.9**	**47.0**
	SP November 2004	45.0	44.9	44.6	44.1	**n.a.**
	SP October 2003	45.1	44.7	44.8	44.6	n.a.
	COM Nov 2005	45.0	47.0	47.6	48.0	n.a.
Real GDP (% change)	**SP December 2005**	**1.7**	**¾**	**2 ½**	**2 ½**	**2 ½**
	SP November 2004	1¼	1½	2½	2½	n.a.
	SP October 2003	1	2½	2½	2½	n.a.
	COM Nov 2005	1.7	0.5	2.0	2.4	n.a.

Source:
Stability programmes (SP) and Commission services' autumn 2005 economic forecasts (COM)

Figure 1: General government balance projections in successive stability programmes (% of GDP)



Source : Commission services' autumn 2005 forecast (COM) and successive

Regarding the execution of the 2005 budget, the update estimates that the general government deficit (coming from 3.2% of GDP in 2003) has continued to fall from 2.1% of GDP in 2004 to 1.2% of GDP in 2005. This compares to a deficit target of 2.6% of GDP in the November 2004 update and a projection 1.8% of GDP in the Commission services' autumn 2005 forecast. While the programme does not explain the better-than-expected performance compared to the previous update in full detail, the Autumn memorandum[12] submitted to Parliament on 25 November 2005 provides details on budgetary implementation. It shows that 1.2% of GDP of this better performance can be attributed to better-than-expected revenues, mainly from higher gas prices (0.3% of GDP) and higher-than-expected tax revenues (totalling 0.9%), while the remaining 0.2% is due to lower-than expected expenditure.

On the revenue side, the better tax revenues occurred in several categories. Corporate profit taxes turned out higher by 0.3% of GDP. While this is in part (0.1% of GDP) due to higher profits, it mainly (0.2% of GDP) reflects the fact that companies paid more taxes in advance than expected. This was the unintended result of a Government decision that came into effect on 1 January 2005, to increase the interest rate on tax refunds to 5% (i.e. above market interest rates). Corporations took advantage of the above-market interest rate by making higher tax advance payments. As a result, corporate tax revenues in 2005 were boosted by 0.2% of GDP. Once this outcome was recognised by Government, the level of interest rates on taxes paid in advance was lowered, as from 1 January 2006. As a result, a mirror effect is expected in 2006, amounting to deterioration in the government balance of 0.2%.

[12] The Autumn memorandum is a briefing to Parliament on budgetary developments. It contains updated information on the development of revenues and expenditures. If expenditure ceilings are not respected, additional measures may be taken.

On the expenditure side, lower-than-expected spending on a broad range of items amounting to around 0.3% of GDP was to some extent offset by higher payments to the EU and outlays on development aid.

After the publication of the December 2005 update of the Stability Programme, new information on the budget balance has become available. According to the information provided to Parliament on 21 January[13], the deficit in 2005 is estimated to be even lower than foreseen in the update, at ¾% of GDP. Two main factors explain this further improvement. First, tax revenues and social security premiums were further revised upwards (0.2% of GDP), probably reflecting the strengthening of the economy in the latter part of the year. Second, total central government expenditure was lower than expected in the update by around 0.4% of GDP. This is mainly due to the fact that progress with infrastructure projects was hampered by environmental constraints. By contrast, the balance of the sub-sector local government deteriorated by 0.2% of GDP. Due to the preliminary nature of the currently available projections, it is difficult to assess whether and what kind of carry-over effects for 2006 these adjustments have. While some effects linked to the better-than-expected economic situation could contribute to a lower deficit also in 2006, the shortfalls in infrastructure investment could lead to higher expenditure in later years, should it be possible to overcome existing bottlenecks.

3.2. The programme's medium-term budgetary strategy

This section covers the following aspects of the medium-term budgetary strategy outlined in the programme: (i) the main goal of the budgetary strategy; (ii) the composition of the budgetary adjustment, including the broad measures envisaged; and (iii) the programme's medium-term objective and the adjustment path towards it in structural terms.

3.2.1. The main goal of the programme's budgetary strategy

The authorities' main strategic objective expressed in the update is to achieve sound public finances to support sustainable economic growth and absorb the costs of ageing. In this update the Government aims at achieving a general government balance that respects the medium-term objective of a structural deficit in the range of 0.5 to 1% of GDP, i.e. in cyclically-adjusted and net of one-off and other temporary measures throughout the programme period.

After the substantial consolidation that was achieved in 2004 and 2005, which reduced the deficit from 3.2% in 2003 to 1.2% in 2005, thus correcting in one year the excessive deficit that had occurred in 2003 and continuing thereafter the consolidation, the general government balance shows no further improvement over the programme period 2005-2008. The update foresees the general government deficit to widen from 1.2% of GDP in 2005 to 1.5% in 2006 but to decline gradually thereafter, to 1.1% in 2008. It is, however, worth noting that the update underlines that the Government will present new figures for the budget balance in 2005 and 2006 in Spring 2006 and that the figures for 2007 and 2008 are hence of a technical nature; this suggests that there may also be a revision of the projections for 2007 and 2008 at that moment. The time profile of the primary surplus is

[13] Letter of minister Zalm to parliament, 21 January 2006.

similar to that of the general government balance, with a small improvement from 1.4% in 2005 to 1.5% at the end of the period.

Compared with the previous programme which foresaw a continued deficit reduction from an expected 2.6% of GDP in 2005, the new update is considerably different since it takes into account the better-than-expected deficit outcome of 1.2% of GDP in 2005 and broadly maintains the general government deficit at 1.2% of GDP (except for a deterioration in 2006), against the background of a comparable macroeconomic scenario from 2006 onwards.

Table 4: Composition of the budgetary adjustment

(% of GDP)	**2004**	**2005**	**2006**	**2007**	**2008**	**Change: 2008-2005**
Revenues	45.0	46.0	47.3	46.9	47.0	**1.0**
of which:						
- Taxes & social contributions	38.7	39.2	40.2	n.a.	n.a.	**n.a.**
- Other (residual)	6.3	6.8	7.1	n.a.	n.a.	**n.a.**
Expenditure	47.1	47.2	48.8	48.1	48.1	**1.0**
of which:						
- Primary expenditure	44.4	44.6	46.2	45.5	45.5	**0.9**
of which:						
Collective consumption	10.7	10.7	10.5	10.5	10.5	**-0.2**
Transfers & subsidies[1]	26.9	26.8	28.3	27.8	27.8	**1.0**
Gross fixed capital formation	3.1	3.1	3.0	3.0	3.0	**-0.1**
Other (residual)	3.7	4.0	4.4	4.2	4.2	**0.2**
- Interest expenditure	2.7	2.6	2.6	2.6	2.6	**0.0**
General government balance (GGB)	**-2.1**	**-1.2**	**-1.5**	**-1.2**	**-1.1**	**0.1**
Primary balance	**0.6**	**1.4**	**1.1**	**1.4**	**1.5**	**0.1**
One-off and other temporary measures	0	0	0	0	0	0
GGB excl. one-off & other temporary measures	**-2.1**	**-1.2**	**-1.5**	**-1.2**	**-1.1**	**0.1**

Note:
[1] Only subsidies, Transfers other than in kind are covered in Other (residual).

Source:
Stability programme update; Commission services' calculations

3.2.2. The composition of the budgetary adjustment in the programme

The December 2005 update of the Stability Programme expects the general government deficit to stabilise at around the better-than-expected deficit outcome in 2005 of 1.2% of GDP, except for a deterioration in 2006 to 1.5% of GDP, which mainly stems from an expected fall in tax revenues on production and income. Over the programme period, total receipts are expected to increase by 1.0% of GDP, while expenditures are expected to increase by 0.9% of GDP. The programme provides no detailed account of the factors behind the projected changes in the expenditure and revenue ratios. The CPB Autumn forecast[14] notes that in 2006 both total receipts and total expenditure are strongly influenced by the reform of the health insurance system (whereby part of former private insurance has been brought into the collective sphere as of 2006). This results in higher social transfers, as well as higher health insurance contributions. Corrected for the impact

[14] CPB, Macro Economische Verkenning 2006.

of the reform of the health-care system, the expenditure and revenue ratios would be virtually unchanged.

Public investment is projected to remain stable at around 3% of GDP, which is around half a percentage point higher than the EU average.

While the headline general government deficit is expected to remain fairly stable from 2005 to 2008, the breakdown by sub-sector of government shows noticeable shifts. The projected deterioration in the central government balance from -1.1% to -2.2% of GDP is offset by projected improvements in the balances of local government and social security funds. The programme gives no detailed explanation for the changes by sub-sector. The unexpectedly high deficits of local governments in 2003 and 2004, mainly due to large construction projects, are expected to be gradually reduced over the programme period in line with the finalisation of projects and the economic recovery. The surpluses of social security funds are expected to increase partly due to the effect of the reforms in the health and social insurance systems, which affect the relation between premium revenues and transfers and thus the central government balance.

Box 1: The budget for 2006

The draft budget for 2006 was presented on 21 September 2005 and was adopted in parliament on 6 October 2005.

The budget targets a general government deficit of 1.8% of GDP in 2006, which at the time was the same as the general government deficit envisaged for 2005. This stabilisation of the projected deficit comes at a time of increasing economic growth, projected to improve markedly from ½% in 2005 to 2½% in 2006. It is the first budget since 2002 that plans a budgetary expansion in real terms.

The major structural change in 2006 is the change in the system of health insurance that eliminated the dual system that was in effect until 2005. The health-care reform is accompanied by a compensation package of €1 billion that was decided upon earlier. In addition, in the budget for 2006 the government decided on a new compensation of € ½ billion or 0.1% of GDP. In the old system, those who were privately insured co-financed the elderly in the public insurance scheme via a premium that was levied in the following year. In the budget for 2006, it was decided to cancel this premium for 2006 as it would imply a levy on an insurance that no longer exists.

Due to higher gas revenues, the inflow into the fund for strengthening the economic structure (Fonds Economische Structuurversterking, FES) is expected to be higher. Approximately €0.6 billion of the expected extra revenue will be spent in 2006.

Other measures on the revenue side are predominantly aimed at improving disposable income. They include increasing the general tax breaks and lowering unemployment premiums by 0.5 percentage point.

On the expenditure side, several additional outlays are planned, e.g. to cover the cost of including biometrics in passports (€0.3 billion) and combating infectious diseases (€0.3 billion). Furthermore, child care expenditures are increased to alleviate bottlenecks and to lower private contributions to child care (€0.2 billion). Also, tuition fees for 16 and 17 year old children have been abolished (a measure which already came into effect in September 2005).

3.2.3. *The programme's medium-term objective (MTO) and the adjustment path in structural terms*

According to the Stability and Growth Pact, stability and convergence programmes should present a medium-term objective (MTO) for the budgetary position. The MTO should be differentiated for individual Member States, to take into account the diversity of economic and budgetary positions and developments as well as of fiscal risk to the sustainability of public finances. The country-specific MTO is defined in structural terms (i.e. cyclically-adjusted, net of one-off and other temporary measures) and should fulfil a triple aim, namely (i) provide a safety margin with respect to the 3% of GDP deficit limit; (ii) ensure rapid progress towards sustainability; and (iii), taking (i) and (ii) into account, allow room for budgetary manoeuvre, considering in particular the needs for public investment. The code of conduct (Section I thereof) further specifies that, as long as the methodology for incorporating implicit liabilities is not fully developed and agreed by the Council, the country-specific MTOs are set taking into account the current government debt ratio and potential growth (in a long-term perspective), while preserving a sufficient margin against breaching the deficit reference value of 3% of GDP. Member States are free to set an MTO that is more demanding than strictly required to achieve the triple aim of MTOs.

The update sets an MTO in the range of -1% to -0.5% of GDP. The programme aims to respect this range throughout the programme period. Based on Commission services' calculations on the basis of the programme according to the commonly agreed methodology, the structural balance improved markedly from -2.2% of GDP in 2003 to 0.0% of GDP in 2005. This reflects a strong adjustment effort of over 1 percentage point of GDP per year on average after the excessive deficit occurred in 2003, even without taking into account the above-mentioned recent information on the better-than-expected outcome in 2005. Based on these same calculations, the structural balance would deteriorate in 2006 by nearly three quarters of a percentage point of GDP to stabilise thereafter at a deficit slightly above half a percentage point of GDP in 2007 and 2008. A large part of this deterioration (0.4 percentage point of GDP) can be explained by the shift in the temporal allocation of corporate tax revenues, as explained in section 3.1. Despite the expected fiscal loosening in 2006, the structural deficit is projected to remain within the MTO-range set in the programme. As is apparent from Table 5, for the period 2006-2007 the projected path of the structural balance according to the Commission services' autumn 2005 forecasts is very close to the one calculated from the programme. By contrast, the difference of 0.6% of GDP in the structural balance in 2005 is due to the higher nominal deficit estimate in the Commission services' forecast.

Table 5: Output gaps, cyclically-adjusted and structural balances

% of GDP	**2004**		**2005**		**2006**		**2007**		**2008**	**Change: 2008-2005**
	COM	**SP[1]**	**COM**	**SP[1]**	**COM**	**SP[1]**	**COM**	**SP[1]**	**SP[1]**	**SP[1]**
Gen. gov't balance	-2.1	-2.1	-1.8	-1.2	-1.9	-1.5	-1.5	-1.2	-1.1	0.1
One-offs[2]										-
Output gap[3]	-1.3	-1.6	-2.2	-2.3	-1.9	-1.5	-1.4	-0.9	-0.6	-
CAB[4]	-1.4	-1.3	-0.6	0.1	-0.8	-0.7	-0.7	-0.6	-0.6	-0.7
change in CAB										-
CAPB[4]	1.2	1.5	1.9	2.6	1.7	1.9	1.8	2.0	2.0	-0.6
Structural balance[5]	-1.4	-1.3	-0.6	0.1	-0.8	-0.7	-0.7	-0.6	-0.6	-0.7
change in struct. bal.										-
Struct. prim. bal.[6]	1.2	1.5	1.9	2.6	1.7	1.9	1.8	2.0	2.0	-0.6
Notes:										

[1]Output gaps and cyclical adjustment according to the stability (SP) as recalculated by Commission services on the basis of the information in the programme.
[2]One-off and other temporary measures.
[3]In percent of potential GDP. See Table 1 above.
[4]CAB = cyclically-adjusted balance; CAPB = cyclically-adjusted primary balance.
[5]CAB excluding one-off and other temporary measures.
[6]Structural primary balance = CAPB excluding one-off and other temporary measures.

Source:
Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations

3.3. Assessment

This assessment is in three parts. The first assesses the appropriateness of the programme's medium-term objective. The second analyses risks attached to the budgetary targets and the third examines whether the budgetary strategy laid down in the programme is consistent with the budgetary objectives of the Treaty and the Stability and Growth Pact.

3.3.1. Appropriateness of the programme's medium-term objective

The programme's MTO is set as a range from -0.5% to -1% of GDP. As the lower bound of this range is equal to the minimum benchmark (estimated at a deficit of around 1% of GDP), its achievement should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit.

The programme's MTO is at an appropriate level because it lies within the range indicated for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct and adequately reflects the debt ratio and average potential output growth in the long term.

3.3.2. Risks attached to the budgetary targets

Overall, the risks to the budgetary projections in the programme's baseline scenario for 2006 and beyond appear broadly balanced, if somewhat cautious in the outer years, when outcomes could be better. A first element to consider is that according to the latest available information on budgetary implementation in 2005, the deficit is expected to be substantially lower than projected in the programme update (see section 3.1). However, due to the lack of details on the likely (non)recurrence of higher revenues and lower expenditures compared to the programme baseline, an assessment of the carry-over effects into 2006 and beyond is difficult to provide[15]. While some effects linked to the better-than-expected economic situation could contribute to a lower deficit also in 2006, the shortfalls in infrastructure investment could lead to higher expenditure in later years, should it be possible to overcome existing bottlenecks.

Compared with the Commission services' autumn 2005 forecast, current indicators suggest a strong pick-up in economic activity from the second half of 2005 onwards, with positive effects on economic growth, income, profits and tax revenue and the

[15] For instance, as mentioned earlier, lower-than-expected outlays for investment may in principle be compensated in later years, but experience shows that delays in the execution of works may be extended for a longer period if they stem from capacity and/or environmental constraints.

general government balances. The programme scenario for 2006 is in line with this new information. On the other hand, there exists a possible negative risk to the programme's economic growth projection in 2006 due to the possibility that the price of oil could turn out higher than assumed, and hence be more close to the Commission services' autumn forecast[16]. However, the risk for the government balance in 2006 would be very limited. Model-based scenario analyses from the CPB suggest that if the oil price were to turn out higher than anticipated in the programme, the negative impact on economic activity and government revenue would be broadly offset by higher gas receipts[17], provided that outlays from the FES (the fund on strengthening economic structure) are not adjusted accordingly in the short term in response to changes in gas revenue.

For 2007 and 2008, the analysis changes significantly. For those years, the programme assumes an oil price of $26 (as against $60.3 in the common external assumptions for 2007 - common assumptions are not available for 2008). As concluded in Section 2 of this assessment, the programme's macroeconomic scenario is not consistent with an oil price of $26, but must implicitly assume a much higher oil price. Therefore, if the actual oil price were to turn out significantly higher than $26, the macroeconomic effects are likely to be limited. Similarly, the effects on non-gas revenues are likely to be limited. On the other hand, the expected revenues projected in the programme from the sale of gas *are* consistent with the assumed oil price of $26. As a consequence, should the oil price turn out higher than anticipated in the programme, this would generate a positive risk to the government balance in 2007 and 2008. As the price of natural gas follows the oil price with a lag, the effect is likely to be most prominent in 2008.

For the period 2007 to 2008 the programme does not provide details on the envisaged budgetary measures as required by the code of conduct. In particular, the budgetary implications of the substantial reforms in health, social security and pension systems from 2006 onwards are not specified. On balance such reforms should help improve the sustainability of Dutch public finances. However, in several areas, such as child care and health care, it is not yet fully clear how proposed measures will influence the actual behaviour of economic agents. The reforms may thus not fully achieve their intended aim, for instance of raising labour participation or limiting the use of medical facilities. In terms of the budgetary impact of the reforms uncertainties cannot be ruled out.

In 2007 and 2008, the surplus of social security funds is expected to increase to 0.9% of GDP and 1.3% of GDP respectively, from 0.3% in 2006. There is a risk that the improvement of the social security funds will lead to calls for lowering social security premiums. If these calls are answered, the expected increase in the central government deficit needs to be compensated for, or it will translate into a deterioration of the budgetary position in those years. On the other hand, the budgetary system with multi-annual expenditure ceilings in real terms that is in place in the Netherlands should be instrumental in securing the programme's targets.[18]

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[16] $50/barrel in the programme as compared to $61.4 in the common external assumptions, which at present seem more plausible (see section 2)

[17] A distinctive feature of the Dutch government balance is the revenue from the sale of natural gas. Total gas receipts (including corporate tax revenue from the gas sector) amounted to around 1.6% of GDP in 2005.

[18] This system entails that higher-than-projected revenues should not be used to finance expenditure growth in excess of the predetermined ceilings. Additionally, the recently concluded agreement to monitor local government finances more closely in order to help counter unexpected deteriorations in

Moreover, comparison of tax projections in the programme and the Commission services' autumn 2005 forecasts shows a large correspondence in the forecast of the overall tax-to-GDP ratio (see Table 6), with the programme forecast assuming a somewhat lower overall elasticity of tax receipts to GDP in 2007 as compared to Commission services' forecasts. Hence, in that year the programme assumptions appear to be somewhat more cautious. In 2008, the programme expects the overall tax elasticity to revert to unity (table 6), a value close to the ex-ante elasticity estimated by the OECD[19].

Table 6: Assessment of tax projections

	2006		**2007**		**2008**	**p.m.: OECD[1]**
	COM	**SP**	**COM[2]**	**SP**	**SP**	
Total taxes Change in tax-to-GDP ratio	0.9	1.0	0.4	0.0	0.0	/
Difference	0.1		-0.4		/	/
of which[3]: - elasticity component	-0.4		-0.2		/	/
- composition component	0.4		0.0		/	/
p.m.: Observed elasticity to GDP	1.8	1.7	1.3	1.0	1.0	1.01

Notes:
[1]OECD ex-ante elasticity relative to GDP.
[2]On a no-policy change basis.
[3]The decomposition is explained in Annex 4.

Source:
Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations and OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434)

3.3.3. Compliance with the budgetary requirements of the Treaty and the Stability and Growth Pact

Taking into account the risk assessment above, the budgetary strategy outlined in the programme seems sufficient to ensure that the programme's MTO is maintained throughout the programme period. As the programme's MTO is set within an appropriate range, its respect also entails a sufficient safety margin against breaching the 3% of GDP threshold for the deficit.

3.4. Sensitivity analysis

The programme analyses the effects on the budgetary outcomes of some changes in economic variables. It first summarises the results presented in the latest macroeconomic outlook of the Netherlands Bureau of Economic Policy Analysis (CPB) about the effects

the general government balance according to ESA definitions should also help contain the local government deficits.

19 A more detailed analysis of tax projections by main category is given in Annex table A.4.1. One should, however, interpret such detailed estimates with caution because of composition effects that are due to a host of factors such as fuel excises, pension premiums, fluctuations in corporate profits, cyclically-induced shifts in consumption patterns and special factors. As an example of the latter, for 2005, the purchase of a gas distribution company by government (which does not affect the ESA deficit) had a large upward impact on VAT and corporate tax revenues of 0.8% of GDP, distorting the statistical relation between tax receipts and the tax-base.

of a higher oil price in 2006[20]. As already stated, according to this analysis, should the oil price reach USD 65 per barrel in 2006 instead of USD 50 as assumed both in the CPB forecasts and in the programme, real GDP growth would be 0.6% lower, due to significantly slower growth in private consumption, investment and exports. However, the effect on the general government balance would be zero because higher non-tax revenues from natural gas would compensate for lower taxes and social contributions. Similarly, the programme presents an estimate of higher long-term interest rates (by ½% in 2006 and 1% in 2007). In that case, GDP growth would be 0.4 percentage points lower in 2006 and 1.5 percentage points lower in 2007 and the general government deficit would be respectively 0.2 and 0.8 percentage point of GDP higher cumulatively. Finally, the programme presents an estimate of the effects of a 10% appreciation of the euro: in that case, GDP growth would be 0.9% lower both in 2006 and 2007 and the general government balance would deteriorate by 0.1 and 0.2 percentage point of GDP respectively with respect to the central projection. These estimates seem plausible, but the programme is not very explicit about the underlying assumptions about how revenues and expenditure are projected to react to variations in economic variables as would be required by the new code of conduct. In particular, the programme does not explain why the effects of higher interest rates on budgetary outcomes are much larger than those of an appreciation of the euro (a cumulative 0.8 percentage point of GDP deterioration compared to a deterioration of 0.2 percentage point) while their effects on GDP growth are less divergent (the cumulative GDP loss is 1.5% with higher long-term interest rates - by ½%-point in 2006 and 1%-point in 2007 - and 0.9% with a 10% appreciation of the euro).

Commission services' simulations of the cyclically-adjusted balance under the assumptions of (i) a sustained 0.5 percentage point deviation from the real GDP growth projections in the programme over the 2005-2008 period, (ii) trend output based on the HP-filter[21] and (iii) no policy response (notably, the expenditure level is as in the central scenario[22]), reveal that, by 2008, the cyclically-adjusted deficit is 0.6 percentage point of GDP above the central scenario. Hence, in the case of persistently lower real growth, additional measures of around 0.6 percentage point of GDP would be necessary to keep the public finances on the path targeted in the central scenario[23].

4. GENERAL GOVERNMENT GROSS DEBT

This section is in two parts: the first describes the debt path envisaged in the programme and the second contains the assessment.

[20] See point 2 economic outlook above.

[21] In the absence of a fully-specified macroeconomic scenario that would underlie such deviations, it is obviously impossible to derive new estimates of potential growth from the agreed production function method.

[22] The effect of lower/higher growth on revenues is captured by using the conventional sensitivity parameters adopted in cyclical adjustment procedures.

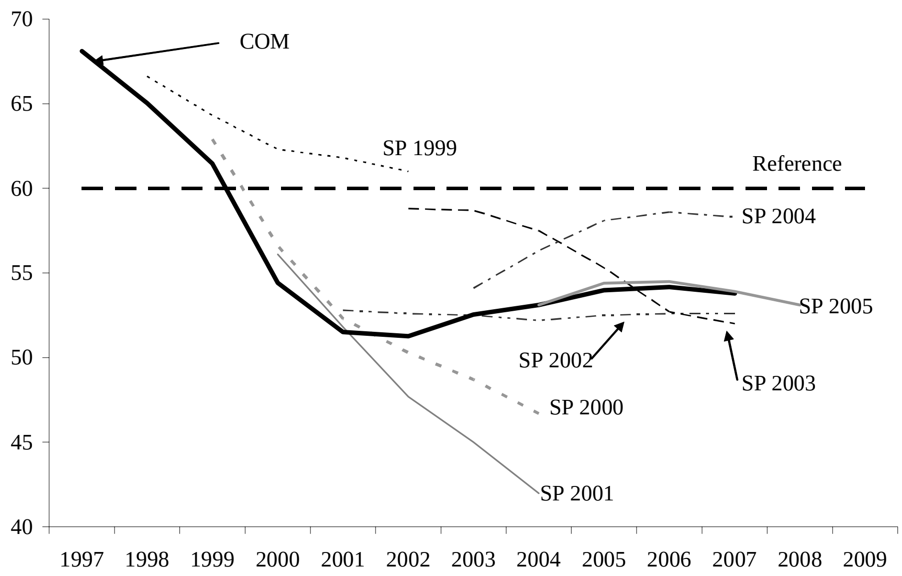
[23] Unexpected changes in inflation are not assumed to affect the expenditure-to-GDP ratio, as nominal expenditure should broadly move in lockstep with the price level.

4.1. Debt developments in the programme

According to the programme, the debt-to-GDP ratio rose from 53.1% at the end of 2004 to 54.4% at the end of 2005. This 1.3 percentage point of GDP increase has been the result of a 1.4% of GDP primary surplus, interest expenditures amounting to 2.6% of GDP, stock-flow adjustment amounting to -1.8% of GDP and a higher denominator (nominal GDP), of 1.7% of GDP. The most important factors of the stock-flow adjustment are the sale of financial assets (0.4% of GDP) and the purchase of shares in the gas transport company “Nederlandse Gasunie Transport” (0.6% of GDP).

The previous programme projected the debt ratio to rise in 2005 by 1.8 percentage point of GDP, from 56.3% to 58.1% of GDP. The large difference between the debt ratios in the 2004 and the 2005 programmes stems from an upward shift in GDP by a significant amount (e.g. 4.3% in 2001, 4.5% in 2002, 4.9% in 2003 and 4.8% in 2004) which by itself led to a fall in the debt ratio by around 2.7 percentage points of GDP in 2004. It also reflects for 2005 the lower-than-expected deficit in the current compared to the previous update.

Figure 2: Debt projections in successive stability programmes (% of GDP)



Source : Commission services' autumn 2005 forecast (COM) and successive

The programme projects the debt ratio to broadly stabilise in 2006 (at 54.5% of GDP compared to 54.3% of GDP) before decreasing again to 53.9% of GDP in 2007 and to 53.1% of GDP in 2008. Throughout this period, the primary surplus is projected to fluctuate between 1.1 and 1.5% of GDP, while interest expenditure would remain stable at 2.6% of GDP. In 2006, there should be additional sales of financial assets amounting to 0.3% of GDP. On the other hand, a change in the legislation on social security will result in a postponement of the actual payment of employers’ contributions. This change has no effect on the general government deficit, which is accruals-based, but will result in an increase in the government debt level, amounting to 0.3% of GDP in 2006.

Table 7: Debt dynamics

	average 2000-2004	2005		2006		2007		2008
	COM	COM	SP	COM	SP	COM	SP	SP
Government gross debt ratio[1]	**52.6**	**54.0**	**54.4**	**54.2**	**54.5**	**53.8**	**53.9**	**53.1**
Change in debt ratio (1 = 2+3+4)	-1.7	0.9	1.3	0.2	0.1	-0.4	-06	-0.8
Contributions:								
- **Primary balance** (2)	**-1.9**	**-0.7**	**-1.4**	**-0.6**	**-1.1**	**-1.0**	**-1.4**	**-1.5**
- **"Snow-ball" effect** (3)	**0.5**	**1.8**	**1.0**	**1.0**	**0.7**	**0.3**	**0.9**	**0.9**
- Interest expenditure	3.0	2.5	2.6	2.5	2.6	2.4	2.6	2.6
- Real GDP growth	-0.7	-0.3	-0.4	-1.0	-1.3	-1.2	-1.3	-1.2
- Inflation (GDP deflator)	-1.8	-0.4	-0.8	-0.5	-0.6	-0.9	-0.4	-0.5
- **Stock-flow adjustment** (4)	**-0.3**	**-0.2**	**1.3**	**-0.1**	**0.5**	**0.3**	**-0.1**	**-0.2**
- Cash/accruals	0.1							
- Accumulation of financial assets	-0.4							
of which: Privatisation proceeds	-0.2							
- Valuation effects & residual adj.	0.1							

Note:
The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D, PD, Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth. The term in parentheses represents the "snow-ball" effect.

[1] GDP projections and debt ratio based on data from the Stability Programme. Note that projected GDP includes FISIM, while debt ratios have been calculated based on GDP excluding FISIM, as provided in the Stability Programme. The resulting discrepancy shows up as stock-flow adjustment.

Source:
Stability programme update (SP); Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations

4.2. Assessment

The debt projections of the programme are very close to those of the Commission services, the difference being only 0.2 or 0.3% of GDP depending on the year considered. Risks to the debt ratio forecasts stem primarily from the risks to the deficit and GDP projections and appear broadly balanced.

5. STRUCTURAL REFORM, THE QUALITY OF PUBLIC FINANCES AND INSTITUTIONAL FEATURES

The programme only briefly touches upon the significant reforms of the health, social security and pensions systems, which were already partly initiated in 2004 and 2005 but which will mainly take place in 2006[24]. The reforms aim to secure budgetary savings in the longer term, boost labour participation, reduce or remove incentives for early retirement, and increase the efficiency in health care.[25] The programme does not give

[24] A brief and fairly general characterisation of the major reforms is not given in the section on quality of public finances, but in the section on the sustainability of public finances.

[25] A more detailed description of the reforms is developed in CPB, CEP 2005, pp. 155-161 and European Commission, BEPG Implementation Report Spring 2005.

details on the estimated impact of the reforms on public finances, which would have been an important input into this assessment. In many areas, such as health care, the measures are intended to be neutral in budgetary terms.

The programme mentions total additional expenditure of €2.3 billion (0.5% of GDP) to strengthen the economic structure over the total period 2005-2010, but does not explain the timing of these outlays financed by the FES (the fund on strengthening economic structure, largely funded by gas receipts). In the likely event that the oil price were to turn out higher than the USD 26 expected in 2007 and 2008, the FES will receive additional funding. On closer inspection, a substantial part of the planned FES expenditure does not concern investment to strengthen the economic structure, but rather is current expenditure on items such as delayed maintenance of school buildings, anti-terrorism measures, price compensations, and heritage. Such outlays should normally be covered by current revenue. In the current Dutch budgetary framework, windfall gas receipts count as negative expenditure and therefore are not relevant for expenditure ceilings. 42% of the gas receipts are used to fund the FES and the rest is directed to deficit reduction. However, if funds routed through the FES are de facto used for current outlays, at the level of general government this allows for expenditure growth in excess of the budgetary projections.

The programme mentions additional outlays on child care, which are intended to improve the accessibility and demand of child care facilities. However, it does not provide the perspective that this measure was taken to partly correct the effects of the earlier reform of the financing in the child care system, which led to higher costs for most parents, reducing the demand for child care and thus hampering an increase in the labour force participation rate of women.

With respect to the development of the tax burden, the Dutch government has decided to reduce the rate of corporate taxes in two steps in 2006 and 2007. This operation has only small budgetary consequences, as it is in large part funded by a commensurate reduction in tax deductions. Despite the fact that the fiscal impact on the corporate sector as a whole is low, representatives from SMEs have expressed concerns that this measure would effectively raise their tax burden while reducing it for large and multinational corporations. The possible strengthening effects on growth potential are difficult to assess ex ante, as they largely depend on the response of corporate fixed capital formation and R&D expenditure.

As regards households, the programme presents a reduction in their fiscal burden by around 0.5% of GDP in 2006. However, this reported reduction is mainly due to the fact that the payment of so-called “care allowance” (introduced by the new health care system) is counted as a reduction in the tax burden, which is not standard practice. According to CPB estimates, the net tax and social security burden for households would not change in 2006.[26]

As regards the budgetary framework, the agreement among central and local government to more closely monitor expenditure of local government entities on an ESA basis from 2006 onwards, in order to avoid an unintended breach of budgetary discipline at the level of general government, is welcome as it heightens awareness and will make it easier to

[26] CPB, Macro Economische Verkenning 2006.

intervene in time if local government deficits threaten the general government balance significantly.

Finally, in discussing the importance of reducing the administrative burden on enterprises, the programme indicates that the majority of Dutch business circles perceive the so-called “Brussels bureaucracy” as being responsible for a large part of the administrative burden. No mention is made of the intention of the European Commission to cut the burden appreciably nor is it recalled that regulations and administrative rules ultimately have a legal basis in the Council, where the Member States have the final say.

The reforms of the health, social security and pensions system mentioned above are broadly consistent with the broad economic policy guidelines in the area of public finances (see Annex 3) and are in line with the National Reform Programme (NRP), submitted on October 14, 2005 in the context of the renewed Lisbon strategy for growth and jobs, which identifies (i) improving labour supply; (ii) faster growth in labour productivity through strengthening R&D and innovation; and (iii) improving price competitiveness through containing labour costs as challenges . Policy measures to increase labour productivity through strengthening R&D and innovation will in part be funded by the FES. However, given the lack of information on the timing of the reforms, it is difficult to ascertain whether the actions envisaged in the NRP are fully taken into account in the budgetary projections.

6. THE SUSTAINABILITY OF THE PUBLIC FINANCES

The assessment of the sustainability of Dutch public finances is based on an overall judgement of the results of quantitative indicators and qualitative features. The debt projections and sustainability indicators are calculated according to two different scenarios, to take into account different budgetary developments over the medium term. The ‘programme scenario’ assumes that the medium-term budgetary plans set up in the programme are actually achieved. The ’2005 scenario’ assumes that the structural primary balance[27] remains unchanged at the 2005 level throughout the programme period.

On the basis of this information, age-related expenditure is foreseen to increase by 6.3% of GDP between 2008 and 2050, to which health-care and pension expenditures equally contribute (see Table A.5.1 in the Annex). The Commission services’ analysis is based on the set of government expenditure items covered by the common projections carried out by the Economic Policy Committee (EPC)[28]. Table 6.1 of the updated programme also provides an increase in revenue/GDP ratio of around 3.1% of GDP between 2010 and 2050. To ensure full comparability with other countries, this rise in revenue is not taken into account in the leading quantitative indicators. It is however taken into account in the qualitative analysis.

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[27] This refers to the primary balance, where the effects of the cycle and any one-off or temporary measures have been netted out).

[28] The Dutch programme only includes long-term projections of public pension expenditure and health-care. Long-term projections are the same as in last year’s programme. The coverage of public pension expenditure in the programme is different from AWG and does not include disability. Other expenditure items and revenues are assumed to remain constant as a share of GDP over the projection period.

The gross debt-to-GDP ratio, currently below the reference value of 60%, would exceed it by 2030 and rapidly reach an explosive path in both scenarios[29] (see Table A.5.4 in the Annex).

Indeed, according to the S1 indicator, a sustainability gap of around 2% of GDP arises in the '2005' scenario. A somewhat higher gap (of around 3%) would emerge in the 'programme' scenario. The primary balance remains approximately constant during the programme period, while the output gap closes: the structural primary balance therefore decreases during the period.

A more demanding measure is the government's inter-temporal budget constraint, captured by the S2 indicator, according to which a sustainability gap of about 3½% of GDP emerges in the '2005' scenario and of about 4% of GDP in the 'programme' scenario. The budgetary position is indeed less favourable at the end of the programme than in 2005 due to the deterioration of the structural deficit in 2006 and its stabilization thereafter. This sustainability gap translates into a required primary balance (RPB) of about 5½% of GDP, higher than the structural primary balance of about 2% of GDP of the last year of the programme period. As noted above, the projected rise in the revenue-to-GDP ratio is not taken into account in these calculations.

Moreover, the sustainability gap, as measured by the S2 indicator, would increase by around ¼% GDP if the (budgetary or structural) adjustment was to be postponed by 5 years (see table A.5.3 in the Annex), highlighting that savings can be made over time if action is taken sooner rather than later.

Table 8: Sustainability indicators and the required primary balance

	Sustainability indicators and RPB						
	2005 Scenario			Programme scenario			
	S1	S2	RPB	S1	S2	RPB
Value (of which)	**2.1**	**3.5**	**5.5**	**2.9**	**4.1**	**5.6**
initial budgetary position	*-2.0*	*-2.0*		*-1.4*	*-1.3*	
debt requirement in 2050	*-0.2*	*:*		*-0.1*	*:*	
future changes in budgetary position	*4.4*	*5.5*		*4.4*	*5.5*	

Note: The S1 indicator shows the difference, the sustainability gap, between the constant revenue ratio as a share of GDP required to reach a debt ratio in 2050 of 60% of GDP and the current revenue ratio. The S2 indicator, which shows the difference, the sustainability gap, between the constant revenue ratio as a share of GDP that guarantees the respect of the inter-temporal budget constraint of the government, i.e. that equates the actualized flow of revenues and expenses over an infinite horizon, and the current revenue ratio[30]. The Required Primary Balance (RPB) measures the average primary balance over the first five years of the projection period that results from a permanent budgetary adjustment carried out to comply fully with the inter-temporal budget constraint. See the European Commission ((2005), European Economy, 'Public finances in EMU – 2005, Section II.3 for a further description.

In interpreting these results, several factors need to be taken into account. GDP growth in the programme is projected to be very close to the EPC projections and the unemployment rate in both projections follow a similar pattern (see Table A.5.1 in the

[29] It should be recalled that, being a mechanical, partial equilibrium analysis, projections are in some cases bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast.

[30] The sustainability gap indicators (S1, S2) do not necessarily suggest that taxes should be increased; strengthening the fiscal position by permanently reducing the level of non-age related primary spending could be preferable and has the same impact.

Annex). Overall, the underlying assumptions in the programme can therefore be considered plausible.

The programme provides information on two expenditure items (old-age pension and health-care). No projection of long-term care, education and unemployment benefits is available in the programme, but including education and unemployment projections from previous EPC common projections would have virtually no impact. The *Act on Work and Income according to Capacity for Work* introduced as from 1 January 2006 aims at limiting the annual inflow into disability schemes and therefore reducing disability benefits and increasing labour supply. This reform may have a significant impact on government spending. Indeed, according to the Dutch country fiche to the Ageing Working Group (AWG) of the EPC, public spending on disability would be reduced by 0.9% of GDP between 2004 and 2040 due to recent reforms[31].

A crucial feature in the programme is the rise in the revenue/GDP ratio up to 2050, which, if it fully materialises, would significantly reduce the S1 indicator by 2.1% of GDP and the S2 indicator by 2.7% of GDP and therefore considerably reduce the sustainability risks[32]. This increase in revenue mainly stems from the projected increase in pensions (both public and private) which will induce an increase in direct and indirect taxes[33]. This impact is important in the Netherlands, as private pension schemes currently hold large assets (around 135% of GDP in 2004) and are expected to accumulate them further since, for the next two decades, contributions to these schemes should still be higher than the corresponding pension outlays.

6.1. Overall assessment

With regard to the sustainability of public finances, the Netherlands appears to be at low risk on grounds of the projected budgetary costs of ageing populations. The current level of debt is under the Treaty value of 60% of GDP and the recent improvement of the budgetary situation in the Netherlands has helped alleviate risks to long-term sustainability. The implementation of recent reforms of the disability scheme will also contribute to curb long-term public spending. However, even fully taken into account, the projected future rise in revenue, notably due to delayed taxation of pension may not be sufficient to compensate totally the rise in public expenditure over the long-term. Further budgetary consolidation may therefore be necessary to fully offset the impact of ageing.

* * *

[31] Disability benefits are not included in the pension projections in the programme, although they are classified as pension expenditure in forthcoming EPC report.

[32] If the rise in the revenue/GDP ratio fully materialises, S1 would be -0.0% GDP in the 2005 scenario and 0.8% of GDP in the programme scenario. S2 would be 0.8% of GDP in the 2005 scenario and 1.5% of GDP in the programme scenario. The RPB would be around 3% of GDP in both scenarios.

[33] In *Ageing in the Netherlands (2000),* a CPB paper which serves as a basis for figures in the stability programme, total revenue is expected to increase by 3.2% of GDP between 2010 and 2050. It is mainly a result of an increase in income tax from pensions of 2.8% of GDP, an increase in indirect taxes from spending financed by pension of 1.8% of GDP and a decrease in revenues from assets, including gas, of 0.8% of GDP. New estimations are expected to be published soon.

Annex 1: Summary tables from the stability programme update

Table 1a. Macroeconomic prospects

	ESA Code	2004 Level	2004 rate of change	2005 rate of change	2006 rate of change	2007 rate of change	2008 rate of change
1. Real GDP	B1*g	488.6	1.7	¾	2½	2½	2¼
2. Nominal GDP	B1*g	488.6	2.6	2¼	3¾	3½	3¼
Components of real GDP							
3. Private consumption expenditure	P.3	239.2	0.0	1½	-2	1¾	2
4. Government consumption expenditure	P.3	118.5	0.0	½	9¼	1½	1½
5. Gross fixed capital formation	P.51	81.0	4.9	1½	5¾	5	4
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	0.8	0.8	-¾	¼	0	0
7. Exports of goods and services	P.6	328.1	8.5	4¼	5¾	5¾	5½
8. Imports of goods and services	P.7	292.6	7.8	3¾	6½	4½	4¾
Contributions to real GDP growth							
9. Final domestic demand			0.6	½	2	1½	1½
10. Changes in inventories and net acquisition of valuables	P.52 + P.53		0.2	-¼	0	0	0
11. External balance of goods and services	B.11		0.9	½	½	1	¾

Table 1b. Price developments

	ESA Code	2004 Level	2004 rate of change	2005 rate of change	2006 rate of change	2007 rate of change	2008 rate of change
1. GDP deflator		100	0.9	1¼	1	1	1
2. Private consumption deflator		100	1.1	1½	1¾	1½	1½
3. HICP[34]		100	1.4	1.5	1.5	1.1	
4. Public consumption deflator		100	2.2	1	2	1	1
5. Investment deflator		100	1.6	1¼	1	1	1
6. Export price deflator (goods and services)		100	0.4	2¾	1¼	1	1
7. Import price deflator (goods and services)		100	1.1	3½	1¾	1	1

34 Optional for Stability programmes.

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
1. Employment, persons[35]		8157	-1.4	-¼	1½	1¾	1¾
2. Employment, hours worked[36]		11.48	-1,5	-¼	1¼	1	1¼
3. Unemployment rate (%)[37]		479	4.6	4.7	4.2	3.8	3.4
4. Labour productivity, persons [38]		60.5	3.4	1¼	1½	1½	1½
5. Labour productivity, hours worked[39]							
6. Compensation of employees	D.1	249.9	1.5	1¼	2¼	2½	2½

Table 1d. Sectoral balances

% of GDP	ESA Code	2004	2005	2006	2007
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	6.2	6.4	6.1	optional
of which: - Balance on goods and services					
- Balance of primary incomes and transfers					
- Capital account					
2. Net lending/borrowing of the private sector	B.9/ EDP B.9	8.1			
3. Net lending/borrowing of general government	B.9	-2.1	-1.2	-1.5	
4. Statistical discrepancy		-0.2	optional	optional	optional

35 Occupied population, domestic concept national accounts definition.

36 National accounts definition. Contains data that have been corrected by the Dutch authorities after the initial submission of the programme.

37 Harmonised definition, Eurostat; levels.

38 Real GDP per person employed.

39 Real GDP per hour worked.

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 B.9) by sub-sector							
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[40]	227440	47,1	47,2	48,8	48,1	48,1
8. Net lending/borrowing	EDP B.9	-10074	-2,1	-1,2	-1,5	-1,2	-1,1
9. Interest expenditure (incl. FISIM)	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	[41]	2950	0,6	1,4	1,1	1,4	1,5
Selected components of revenue							
11. Total taxes (11=11a+11b+11c)		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		
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[42]		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
17a. Social transfers in kind	P.31=D.63						
17b. Social transfers other than in kind	D.62						
18.=9. Interest expenditure (incl. FISIM)	EDP D.41 incl. FISIM	13024	2,7	2,6	2,6	2,6	2,6
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[43]	227440	47,1	47,2	48,8	48,1	48,1
Pm: compensation of employees	D.1						

40 Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

41 The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41 + FISIM recorded as intermediate consumption, item 9).

42 Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

43 Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 3. General government expenditure by function

% of GDP	COFOG Code	Year X-2	Year
1. General public services	1		
2. Defence	2		
3. Public order and safety	3		
4. Economic affairs	4		
5. Environmental protection	5		
6. Housing and community amenities	6		
7. Health	7		
8. Recreation, culture and religion	8		
9. Education	9		
10. Social protection	10		
11. Total expenditure	TE[44]		

Table 4. General government debt developments

% of GDP		2004	2005	2006	2007	2008
1. Gross debt[45]		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[46]		-0,6	-1,4	-1,1	-1,4	-1,5
4. Interest expenditure (incl. FISIM) [47]		2,7	2,6	2,6	2,6	2,6
5. Stock-flow adjustment		-1,6	0,1	-1,4	-1,8	-1,9
of which:						
- Net accumulation of financial assets[49]						
- Valuation effects and other[50]						
p.m. implicit interest rate on debt[51]		5,1	4,9	4,8	4,8	4,8
Other relevant variables						
6. Liquid financial assets[52]						
7. Net financial debt (7=1-6)						

44 Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

45 As defined in Regulation 3605/93 (not an ESA concept).

46 Cf. item 10 in Table 2.

47 Cf. item 9 in Table 2.

48 The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

49 Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

50 Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

51 Proxied by interest expenditure (incl. FISIM recorded as consumption) divided by the debt level of the previous year.

52 AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2004	2005	2006	2007	2008
1. Real GDP growth (%)		1.7	¾	2½	2½	2¼
2. Net lending of general government	EDP B.9	-2.1	-1.2	-1.5	-1.2	-1.1
3. Interest expenditure (incl. FISIM recorded as consumption)	EDPD.41+ FISIM	2,7	2,6	2,6	2,6	2,6
4. Potential GDP growth (%) (1)		1.5	1.6	1.8	1.9	2.0
contributions:						
Labour		0.24	0.30	0.30	0.31	0.30
Capital		0.51	0.53	0.63	0.71	0.76
TFP		0.75	0.78	0.82	0.87	0.91
5. Output gap		-1.6	-2.3	-1.5	-0.9	-0.6
6. Cyclical budgetary component		0.9	1.2	0.8	0.5	0.4
7. Cyclically-adjusted balance (2-6)		-1.2	0.0	-0.7	-0,7	-0,7
8. Cyclically-adjusted primary balance (7-3)		+1.5	+2.6	+1.9	+1.9	+1.9

(1) Until an agreement on the Production Function Method is reached, Member States can use their own figures (*SP*)

Table 6. Divergence from previous update

	ESA Code	2004	2005	2006	2007	2008
Real GDP growth (%)						
Previous update		1¼	1½	2½	2½	-
Current update		1.7	½	2½	2½	2¼
Difference		½	1	0	0	-
General government 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	+0.6	+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. Long-term sustainability of public finances

% of GDP	**2000**	**2005**	**2010**	**2020**	**2030**	**2050**
Total expenditure			48.0	49.8	55.5	56.3
Of which: age-related expenditures						
Pension expenditure			5.3	6.7	8.9	8.3
Social security pension						
Old-age and early pensions						
Other pensions (disability, survivors)						
Occupational pensions (if in general government)						

Health care			7.7	8.7	10.7	10.7
Long-term care *(this was earlier included in the health care)*						
Education expenditure						
Other age-related expenditures						
Interest expenditure			2.5	2.2	2.6	5.7
Total revenue			44.6	45.7	48.1	47.7
Of which: property income						
of which: from pensions contributions (or social contributions if appropriate)						
Pension reserve fund assets						
Of which: consolidated public pension fund assets (assets other than government liabilities)						
Assumptions						
Labour productivity growth			1 ¾	1 ¾	1 ¾	1 ¾
Real GDP growth			1.8	1.6	1.4	1.8
Participation rate males (aged 20-64)			82.0	81.2	81.5	81.8
Participation rates females (aged 20-64)			66.3	72.6	72.9	73.2
Total participation rates (aged 20-64)			75.0	76.5	76.8	77.1
Unemployment rate			4	4	4	4
Population aged 65+ over total population						

Table 8. Basic assumptions

This table should preferably be included in the programme itself; if not, these assumptions should be transmitted to the Council and the Commission together with the programme.

	2004	2005	2006	2007	2008
Short-term interest rate[53]	2.1	2¼	2½	3½	4½
Long-term interest rate					
USD/€ exchange rate	1.24	1.30	1.30	1.20	1.20
Nominal effective exchange rate	3.0	- ½	-1	4	0
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)					
World excluding EU, GDP growth	5.0	4	4¼	4¼	4¼
EU GDP growth	2.5	1¾	2½	2½	2½
Growth of relevant foreign markets*	7.1	4¾	6¼	6½	6½
World import volumes, excluding EU**	13.9	8.6	8.7	8.4	8.4
Oil prices, (Brent, USD/barrel)	38.2	52	50	26	26

* Taken to be equivalent to the Dutch “relevant wereldhandelsvolume”

** Taken from the autumn 2005 Forecasts of the European Commission

53 If necessary, purely technical assumptions.

Annex 2: Compliance with the code of conduct

The table below provides a detailed assessment of whether the programme respects the requirements of Section II of the new code of conduct. It is in four parts, covering compliance with (i) the window for the date of submission of the programme; (ii) the model structure (table of contents) in Annex 1 of the code; (iii) the data requirements (model tables) in Annex 2 of the code; and (iv) other information requirements. In the main text, points (ii) and (iii) are grouped into the "format" requirements of the code, whereas point (iv) refers to its "content" requirements.

Guidelines in the new code of conduct	Yes	No	Comments
1. Submission of the programme			
Programme was submitted not earlier than mid-October and not later than 1 December[1].		X	Reason for late submission was to allow incorporation of new projections and measures
2. Model structure			
The model structure for the programmes in Annex 1 of the code of conduct has been followed.	X		However, several sections were not supplied or incomplete
3. Model tables (so-called data requirements)			
The quantitative information is presented following the standardised set of tables (Annex 2 of the code of conduct).	X		However, some tables were incomplete
The programme provides all compulsory information in these tables.		X	Upon request, compulsory data have been supplied
The programme provides all optional information in these tables.		X	
The concepts used are in line with the European system of accounts (ESA).	X		
4. Other information requirements			
a. Involvement of parliament			
The programme mentions its status vis-à-vis the national parliament.		X	
The programme indicates whether the Council opinion on the previous programme has been presented to the national parliament.		X	
b. Economic outlook			
Euro area and ERM II Member States uses the "common external assumptions" on the main extra-EU variables.		X	E.g. oil price is set at $26 in 2007 and 2008.
Significant divergences between the national and the Commission services' economic forecasts are explained[2].		X	
The possible upside and downside risks to the economic outlook are brought out.	X		
The outlook for sectoral balances and, especially for countries		X	

Guidelines in the new code of conduct	Yes	No	Comments
with a high external deficit, the external balance is analysed.			
c. Monetary/exchange rate policy			
The convergence programme presents the medium-term monetary policy objectives and their relationship to price and exchange rate stability.			Not applicable
d. Budgetary strategy			
The programme presents budgetary targets for the general government balance in relation to the MTO, and the projected path for the debt ratio.	X		
In case a new government has taken office, the programme shows continuity with respect to the budgetary targets endorsed by the Council.			Not applicable
When applicable, the programme explains the reasons for possible deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify the situation, and provide information on them.	X		
The budgetary targets are backed by an indication of the broad measures necessary to achieve them and an assessment of their quantitative effects on the general government balance is analysed.	X		
Information is provided on one-off and other temporary measures.		X	However, the information was submitted upon request.
The state of implementation of the measures (enacted versus planned) presented in the programme is specified.	X		
If for a country that uses the transition period for the classification of second-pillar funded pension schemes, the programme presents information on the impact on the public finances.			Not applicable
e. "Major structural reforms"			
If the MTO is not yet reached or a temporary deviation is planned from the achieved MTO, the programme includes comprehensive information on the economic and budgetary effects of possible 'major structural reforms' over time.			Not applicable
The programme includes a quantitative cost-benefit analysis of the short-term costs and long-term benefits of such reforms.			Not applicable
f. Sensitivity analysis			
The programme includes comprehensive sensitivity analyses and/or develops alternative scenarios showing the effect on the budgetary and debt position of: a) changes in the main economic assumptions b) different interest rate assumptions c) for non-participating Member States, different exchange rate assumptions d) if the common external assumptions are not used, changes in assumptions for the main extra-EU variables.		X	Only some information on effects of changes in main economic assumptions is provided
In case of such "major structural reforms", the programme provides an analysis of how changes in the assumptions would affect the effects on the budget and potential growth.			Not applicable
g. Broad economic policy guidelines			
The programme provides information on the consistency with the broad economic policy guidelines of the budgetary objectives and the measures to achieve them.		X	
h. Quality of public finances			

Guidelines in the new code of conduct	Yes	No	Comments
The programme describes measures aimed at improving the quality of public finances on both the revenue and expenditure side (e.g. tax reform, value-for-money initiatives, measures to improve tax collection efficiency and expenditure control).	X		
i. Long-term sustainability			
The programme outlines the country's strategies to ensure the sustainability of public finances, especially in light of the economic and budgetary impact of ageing populations.	X		
Common budgetary projections by the AWG are included in the programme. The programme includes all the necessary additional information. (…) To this end, information included in programmes should focus on new relevant information that is not fully reflected in the latest common EPC projections.		X	
j. Other information (optional)			
The programme includes information on the implementation of existing national budgetary rules (expenditure rules, etc.), as well as on other institutional features of the public finances, in particular budgetary procedures and public finance statistical governance.	X		
Notes: [1]The code of conduct allows for the following exceptions: (i) Ireland should be regarded as complying with the deadline in case of submission on "budget day", i.e. traditionally the first Wednesday of December, (ii) the UK should submit as close as possible to its autumn pre-budget report; and (iii) Austria and Portugal cannot comply with the deadline but will submit no later than 15 December. [2]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.			

Annex 3: Consistency with the broad economic policy guidelines

The table below provides an overview of whether the strategy and policy measures in the programme are consistent with the broad economic policy guidelines in the area of public finances included in the integrated guidelines for the period 2005-2008.

Integrated guidelines	Yes	No	Not applicable
1. To secure economic stability			
– Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it[1].	X		
– Member States should avoid pro-cyclical fiscal policies[2].	X		
– Member States in excessive deficit should take effective action in order to ensure a prompt correction of excessive deficits[3].			X
– Member States posting current account deficits that risk being unsustainable should work towards (…), where appropriate, contributing to their correction via fiscal policies.			X
2. To safeguard economic and fiscal sustainability In view of the projected costs of ageing populations,			
Member States should undertake a satisfactory pace of government debt reduction to strengthen public			X

Integrated guidelines	Yes	No	Not applicable
finances.			
– Member States should reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible (…)	X		
3. To promote a growth- and employment-orientated and efficient allocation of resources			
Member States should, without prejudice to guidelines on economic stability and sustainability, re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, ensure that mechanisms are in place to assess the relationship between public spending and the achievement of policy objectives and ensure the overall coherence of reform packages.	X		
Notes: [1]As further specified in the Stability and Growth Pact and the new code of conduct, i.e. with an annual 0.5% of GDP minimum adjustment in structural terms for euro area and ERM II Member States. [2]As further specified in the Stability and Growth Pact and the new code of conduct, i.e. Member States that have already achieved the medium-term objective should avoid pro-cyclical fiscal policies in "good times". [3]As further specified in the country-specific Council recommendations and decisions under the excessive deficit procedure.			

Annex 4: Assessment of tax projections

Table A.4.1 compares the tax projections of the programme with those of the Commission services' autumn 2005 forecast and Table A.4.2 those of the Commission services' autumn forecast with tax projections obtained by using standard ex-ante elasticities, as estimated by the OECD. The tables summarise the results for the total tax-to-GDP ratio. The underlying analysis is carried out exploiting information for the four major tax categories, i.e. indirect taxes, corporate and private income taxes and social contributions (see tables below)[54]. Conceptually, the analysis draws on the definition of a semi-elasticity, which measures the change in a ratio vis-à-vis the relative change in the denominator. The semi-elasticity of the tax-to-GDP ratio of the *i-th* tax $\frac{T_i}{Y}$ can be written as:

$$\eta_i = \frac{d\left(\frac{T_i}{Y}\right)}{dY} Y = \left(\frac{dT_i}{dY}\frac{Y}{T_i} - 1\right)\frac{T_i}{Y} = \left(\frac{dT_i}{dB_i}\frac{B_i}{T_i}\frac{dB_i}{dY}\frac{Y}{B_i} - 1\right)\frac{T_i}{Y} = (\varepsilon_{T_i,B_i}\varepsilon_{B_i,Y} - 1)\frac{T_i}{Y}.$$

where ε_{T_i,B_i} and $\varepsilon_{B_i,Y}$ denote the elasticity of the *i-th* tax T_i relative to its tax base B_i and the elasticity of the tax base B_i relative to aggregate GDP Y respectively.

To the extent that ε_{T_i,B_i} is derived from observed or projected data, it will typically reflect (i) the effect of discretionary measures (including one-offs) and (ii) the tax

54 Private and corporate income taxes are generally not provided, neither in the programme nor in the Commission services' autumn 2005 forecast. Only the aggregate, direct income taxes, is given. For the purpose of this exercise the breakdown is obtained using the average shares over the past ten years, i.e. the composition of direct taxes is assumed to stay constant.

elasticity[55]. By contrast, if ε_{T_i,B_i} is the standard *ex-ante* elasticity, as estimated by the OECD, it will be net of discretionary measures.

The second elasticity $\varepsilon_{B_i,Y}$ can be used as an indicator of the tax intensity of GDP growth; for instance, a higher elasticity of consumption relative to GDP means that for the same GDP growth indirect taxes will be higher.

The definition of a semi-elasticity has two practical implications. First, any change in the tax-to-GDP ratio of the *i-th* tax can be written as the product of the semi-elasticity and GDP growth:

$$d\left(\frac{T_i}{Y}\right) = \eta_i \cdot \frac{dY}{Y}$$

and the change in the total tax-to-GDP ratio is the sum:

$$\sum_i d\left(\frac{T_i}{Y}\right) = \sum_I \eta_i \frac{dY}{Y}.$$

Second, differences between two tax projections can be decomposed into an elasticity component and a composition component:

$$d\left(\frac{T_i}{Y}\right)' - d\left(\frac{T_i}{Y}\right) \approx \left[\left(\varepsilon'_{T_i,B_i}\varepsilon'_{B_i,Y} - 1\right)\frac{T_i}{Y} - \left(\varepsilon_{T_i,B_i}\varepsilon_{B_i,Y} - 1\right)\frac{T_i}{Y}\right]\frac{dY}{Y}$$

If $(\varepsilon'_{T_i,B_i} - \varepsilon_{T_i,B_i}) = \alpha_i$; $(\varepsilon'_{B_i,Y} - \varepsilon_{B_i,Y}) = \beta_i$,

then $d\left(\frac{T_i}{Y}\right)' - d\left(\frac{T_i}{Y}\right) \approx \left[\left(\alpha_i\varepsilon_{B_i,Y} + \beta_i\varepsilon_{T_i,B_i} + \alpha_i\beta_i\right)\frac{T_i}{Y}\right]\frac{dY}{Y}$

where $\alpha_i\varepsilon_{B_i,Y}\frac{T_i}{Y}\frac{dY}{Y}$ determines the elasticity component and $\beta_i\varepsilon_{T_i,B_i}\frac{T_i}{Y}\frac{dY}{Y}$ the composition component. The third component in the equation $\alpha_i\beta_i\frac{T_i}{Y}\frac{dY}{Y}$ measures the interaction of the elasticity and the composition components. It is generally small but can become important in some cases. The tax elasticity relative to GDP of total taxes is obtained as $\varepsilon = \sum_i w_i\varepsilon_{T_tB_i}\varepsilon_{B_iY}$ with w_i the share of the *i-th* tax in the overall tax burden.

The tables below report the results of the assessment of the tax projections presented in the programme by major tax category, which, as mentioned above, are the basis for the aggregated results reported in Tables A.4.1 and A.4.2.

Table A.4.1 Assessment of tax projections by major tax category

	2006		2007		2008	p.m.:
	COM	SP	COM[2]	SP	SP	OECD[1]
Taxes on production and imports:						

[55] The observed or projected elasticity (ex-post elasticity) of the *i*-th tax also includes the effect of other factors (OF) such as discretionary measures: $\frac{\Delta T_i}{T_i} = \varepsilon_{T_i,B_i exante}\frac{dB_i}{B_i} + \frac{OF_i}{T_i} = \varepsilon_{T_i,B_i ex\,post}\frac{dB_i}{B_i}$.

Change in tax-to-GDP ratio	-0.4	-0.4	0.1	n.a.	n.a.	/
Difference	0.0		n.a.		/	/
of which[3]: - elasticity component	0.0		n.a.		/	/
- composition component	0.0		n.a.		/	/
p.m.: Observed elasticity:				n.a.	n.a.	
- of taxes to tax base[4]	0.0	-0.3	1.4			1.00
- of tax base[4] to GDP	-0.4	-0.5	0.9	n.a.	n.a.	1.00
Social contributions:						
Change in tax-to-GDP ratio	1.9	1.8	0.3	n.a.	n.a.	/
Difference	-0.1		n.a.		/	/
of which[3]: - elasticity component	-0.8		n.a.		/	/
- composition component	0.4		n.a.		/	/
p.m.: Observed elasticity:				n.a.	n.a.	
- of taxes to tax base[5]	10.3	6.9	2.6			0.80
- of tax base[5] to GDP	0.5	0.6	0.6	n.a.	n.a.	0.70
Personal income tax[6]:						
Change in tax-to-GDP ratio	-0.4	-0.2	0.0	n.a.	n.a.	/
Difference	0.2		n.a.		/	/
of which[3]: - elasticity component	0.2		n.a.		/	/
- composition component	0.0		n.a.		/	/
p.m.: Observed elasticity:				n.a.	n.a.	
- of taxes to tax base[5]	-1.7	0.4	1.7			2.40
- of tax base[5] to GDP	0.5	0.6	0.6	n.a.	n.a.	0.70
Corporate income tax[6]:						
Change in tax-to-GDP ratio	-0.2	-0.1	0.0	n.a.	n.a.	/
Difference	0.1		n.a.		/	/
of which[3]: - elasticity component	0.1		n.a.		/	/
- composition component	0.0		n.a.		/	/
p.m.: Observed elasticity:				n.a.	n.a.	
- of taxes to tax base[7]	-0.6	0.2	0.7			1.00
- of tax base[7] to GDP	1.5	1.4	1.4	n.a.	n.a.	1.52

Notes:
[1]OECD ex-ante elasticities
[2]On a no-policy change basis
[3]The decomposition is explained in the text above
[4]Tax base = private consumption expenditure
[5]Tax base = compensation of employees
[6]Taxes on income and wealth are split into private and corporate income tax using the average tax share over the past ten years, i.e. the share is assumed to be constant over the programme period
[7]Tax base = gross operating surplus

Source:
Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations and OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434)

Table A.4.2 Assessment of tax elasticities by major tax category

	2006		**2007**	
	COM (observed)	**ex-ante[1]**	**COM[2] (observed)**	**ex-ante[1]**
Taxes on production and imports:				
Change in tax-to-GDP ratio	-0.4	0.0	0.1	0.0
Difference	-0.4		0.1	
of which[3]: - elasticity component	0.1		0.2	
- composition component	0.0		-0.1	
p.m.: Observed elasticity:				
- of taxes to tax base[4]	0.0	1.0	1.4	1.0
- of tax base[4] to GDP	-0.4	1.0	0.9	1.0

Social contributions: Change in tax-to-GDP ratio	1.9	-0.2	0.3	-0.3
Difference *of which*[3]*: - elasticity component* *- composition component*	2.1 2.1 -0.8		0.6 0.7 -0.2	
p.m.: Observed elasticity: - of taxes to tax base[5] - of tax base[5] to GDP	 10.3 0.5	 0.8 0.7	 2.6 0.6	 0.8 0.7
Personal income tax[6]**:** Change in tax-to-GDP ratio	-0.4	0.2	0.0	0.2
Difference *of which*[3]*: - elasticity component* *- composition component*	-0.6 -0.5 0.1		-0.2 -0.1 -0.1	
p.m.: Observed elasticity: - of taxes to tax base[5] - of tax base[5] to GDP	 -1.7 0.5	 2.4 0.7	 1.7 0.6	 2.4 0.7
Corporate income tax[6]**:** Change in tax-to-GDP ratio	-0.2	0.1	0.0	0.1
Difference *of which*[3]*: - elasticity component* *- composition component*	-0.3 -0.3 0.0		-0.1 -0.1 0.0	
p.m.: Observed elasticity: - of taxes to tax base[7] - of tax base[7] to GDP	 -0.6 1.5	 1.0 1.5	 0.7 1.4	 1.0 1.5

Notes:
[1]Tax projections obtained by applying ex-ante standard tax elasticities estimated by the OECD
[2]On a no-policy change basis
[3]The decomposition is explained in the text above
[4]Tax base = private consumption expenditure
[5]Tax base = compensation of employees
[6]Taxes on income and wealth are split into private and corporate income tax using the average tax share over the past ten years, i.e. the share is assumed to be constant over the programme period
[7]Tax base = gross operating surplus

Source:
Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations and OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434)

Annex 5: Indicators of long-term sustainability

Table A.5.1: Underlying assumptions compared

% of GDP	2010		2020		2030		2050	
	EPC	**SCP**	**EPC**	**SCP**	**EPC**	**SCP**	**EPC**	**SCP**
Labour productivity growth	**1.7**	**1.8**	**1.7**	**1.8**	**1.7**	**1.8**	**1.7**	**1.8**
Real GDP growth	**2.1**	**1.8**	**1.7**	**1.6**	**1.3**	**1.4**	**1.7**	**1.8**
Participation rate males (aged 15-64)	**83.1**	**82.0**	**82.8**	**81.2**	**82.3**	**81.5**	**83.2**	**81.8**
Participation rates females (aged 15-64)	**72.4**	**66.3**	**75.4**	**72.6**	**76.2**	**72.9**	**77.6**	**73.2**
Total participation rates (aged 15-64)	**77.8**	**75.0**	**79.1**	**76.5**	**79.3**	**76.8**	**80.5**	**77.1**
Unemployment rate (15-64)	**3.2**	**4.0**	**3.2**	**4.0**	**3.2**	**4.0**	**3.2**	**4.0**
Population aged 65+ over total population	**14.9**	**n.a.**	**18.9**	**n.a.**	**22.7**	**n.a.**	**24.4**	**n.a.**

Table A.5.2: Long-term projections

Main assumptions - programme scenario (as % GDP)	2008	2010	2020	2030	2040	2050	changes	Impact on S2
Total age-related spending	12.7	13.0	15.4	19.6	19.3	19.0	6.3	5.5
Pensions	5.2	5.3	6.7	8.9	8.6	8.3	3.1	2.8
Health care	7.5	7.7	8.7	10.7	10.7	10.7	3.2	2.7
Long-term care	:	:	:	:	:	:	:	:
Education	:	:	:	:	:	:	:	:
Unemployment benefits	:	:	:	:	:	:	:	:
Total primary non age-related spending	32.8	32.8	32.8	32.8	32.8	32.8	0.0	0.0
Total revenues	47.4	47.4	47.4	47.4	47.4	47.4	0.0	0.0

Table A.5.3: The cost of a five-year delay in adjusting the budgetary position according to the S1 and S2

	S1	S2
2005 scenario	**0.3**	**0.2**
Programme scenario	**0.5**	**0.3**

Note: the cost of a delay shows the increase of the S1 and S2 indicators if they were calculated five years later.

Table A.5.4: Debt development

Results (as % GDP)	2008	2010	2020	2030	2040	2050	changes
Programme scenario							
Gross debt	53.1	50.2	51.4	91.1	154.8	223.6	170.5
*Gross debt, i + 1**	*53.1*	*51.2*	*57.7*	*105.9*	*186.0*	*282.2*	*229.1*
*Gross debt, i - 1**	*53.1*	*49.2*	*45.8*	*78.8*	*130.4*	*180.3*	*127.2*
Adjusted gross debt	53.1	50.2	51.4	91.1	154.8	223.6	170.5
2005 Scenario							
Gross debt	48.3	43.7	36.0	64.9	116.5	171.7	123.4
*Gross debt, i + 1**	*48.3*	*44.6*	*41.1*	*76.1*	*139.8*	*215.7*	*167.5*
*Gross debt, i - 1**	*48.3*	*42.8*	*31.4*	*55.8*	*98.4*	*139.3*	*91.0*
Adjusted gross debt	48.3	43.7	36.0	64.9	116.5	171.7	123.4

* *i + 1* and *i + 1* represents the evolution of debt under the assumption of the nominal interest rate being 100 basis points higher or lower throughout the projection period.