COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 22.2.2006
SEC(2006) 237 final

Recommendation for a

# COUNCIL OPINION

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

**On the updated stability programme of the Netherlands, 2005-2008**

(presented by the Commission)

# EXPLANATORY MEMORANDUM

## Background

The Stability and Growth Pact, which entered into force on 1 July 1998, is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. In 2005, the Pact was amended for the first time. The reform acknowledged the Pact's usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Pact, stipulates that Member States have to submit, to the Council and the Commission, stability or convergence programmes and annual updates thereof (Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes). The first stability programme of the Netherlands was submitted on 4 November 1998. In accordance with the Regulation, the Council delivered an opinion on it on 1 December 1998 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. In accordance with the same procedure, updated stability and convergence programmes are assessed by the Commission and examined by the Committee mentioned above, while the Council may examine them.

In these programmes, Member States need to specify their medium-term objective for the budgetary position and set out the policy measures to achieve and maintain it, including the accompanying economic assumptions. Following the reform of the Pact, the medium-term objective should be differentiated for individual Member States in the light of the economic and budgetary heterogeneity in the Union, including as regards the fiscal risk to sustainability. Other elements of the reform are that a more symmetrical approach to fiscal policy over the cycle through enhanced budgetary discipline in economic good times should be achieved, while "major structural reforms" with a verifiable impact on long-term sustainability should be taken into account for a temporary deviation from the medium-term objective or the adjustment path towards it.

Taking into account the Commission services' autumn 2005 forecast, the code of conduct[2], the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances and the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008, the Commission has examined the recently submitted update of the stability programme of the Netherlands and, based on its assessment below, has adopted a recommendation for a Council opinion on it.

[1] OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). All the documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

[2] "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.

**Assessment**

(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[3].

(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.

(3) 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.

(4) The programme projects real GDP growth to increase from an estimated 0.75% 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.

(5) 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 0.75% of GDP, substantially lower than projected in the programme update.

[3] 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.

(6) 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.

(7) 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 0.75% 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.

(8) 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.

(9) 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 0.75% 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.

(10) 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.

(11) 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.

(12) 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.

(13) The National Reform Programme of the Netherlands, submitted on 14 October 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.

Recommendation for a

**COUNCIL OPINION**

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

**On the updated stability programme of the Netherlands, 2005-2008**

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[4], and in particular Article 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [14 March 2006] the Council examined the updated stability programme of the Netherlands, covering the period 2005 to 2008.

(2) 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.

(3) 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-

---

4 OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website: http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

cyclicality and the challenges of ageing population, to take the necessary measures to achieve a budgetary position close to balance thereafter.

(4) 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 estimates presented to Parliament, the 2005 deficit is even likely to be near 0.75% of GDP, substantially lower than projected in the programme update.

(5) The December 2005 update of the Dutch stability programme, covering the period 2005 to 2008, was submitted to the 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 for stability and convergence programmes specified in the new code of conduct[5].

(6) The programme projects real GDP growth to increase from an estimated 0.75% 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 to be on the low side also compared to the Commission services' autumn forecast. This reflects the lower oil price assumption, especially in 2007 and thereafter.

(7) 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, with the primary surplus following a similar pattern. Compared with the previous programme which foresaw a continued deficit reduction, the new update takes into account the better-than-expected deficit outcome in 2005 of 1.2% of GDP and foresees, against the background of a comparable macroeconomic scenario from 2006 onwards, a broad stabilisation at this level (except for a deterioration in 2006).

(8) Based on Commission services' calculations on the basis of the programme according to the commonly agreed methodology, the structural balance, after having improved markedly from a deficit of 2¼% of GDP in 2003 when the excessive deficit occurred to a balanced position in 2005, reflecting a strong adjustment effort in line with the Stability and Growth Pact, would deteriorate to a deficit of nearly 0.75% of GDP in

---

[5] 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.

2006 against a diminishing although still negative output gap. Half of this structural deterioration reflects the fact that companies paid higher-than-expected tax advances in 2005 to take advantage of above-market interest rates paid by the Government, with an expected mirror effect in 2006. The structural deficit balance would stabilise thereafter at a deficit slightly above half a percentage point of GDP. The programme sets the medium-term objective (hereafter MTO) for the budgetary position of a structural (i.e. cyclically-adjusted and net of one-off or other temporary measures) 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 projected fiscal deterioration in 2006, the deficit is expected to remain within the MTO range as set in the programme.

(9) The risks to the budgetary strategy appear broadly balanced and the budget outcome could be even somewhat better than expected beyond 2006. On the one hand, current indicators suggest a strong pick-up in economic activity, the 2005 deficit is now expected to be substantially lower and, 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 since the budget would benefit from higher gas revenues while the growth forecast is already consistent with such a higher oil price. On the other hand, some of the better-than-expected outcome in 2005 may also have negative carry-over effects. Moreover, 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.

(10) 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 0.75% of GDP in the structural balance in 2006 although this is partly due to exceptional factors. If the recent information on 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.

(11) 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 stem primarily from the risks to the deficit projections, which, as stated above, appear broadly balanced.

(12) 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.

(13) 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.

(14) The National Reform Programme of the Netherlands, submitted on 14 October 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, the Council welcomes the efforts of the Dutch Government in 2005 to bring the deficit further below the 3 % of GDP reference value, after the prompt correction of the excessive deficit, as well as the fact that the authorities plan to respect the medium-term objective throughout the programme period. The Council invites the Netherlands, also in view of better-than-expected results in 2005, to maintain a strong budgetary position in 2006 and thereafter.

**Comparison of key macroeconomic and budgetary projections**

| | | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|---|
| Real GDP (% change) | **SP Dec 2005**[1] | **1.7** | **0.75** | **2½** | **2½** | **2¼** |
| | COM Nov 2005 | 1.7 | 0.5 | 2.0 | 2.4 | n.a. |
| | *SP Nov 2004* | *1¼* | *1½* | *2½* | *2½* | *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**[2] | **-1.5** | **-2.3** | **-1.5** | **-1.1** | **-0.9** |
| | COM Nov 2005[4] | -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[3] (% of GDP) | **SP Dec 2005**[2] | **-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] For further calculations, the corresponding point estimates have been used.
[2] Commission services calculations on the basis of the information in the programme.
[3] As there are no one-off and other temporary measures in the programme, the cyclically-adjusted balance and the structural balance are identical.
[4] 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.*