



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 23.1.2007
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Recommendation for a

COUNCIL OPINION

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

On the updated stability programme of the Netherlands, 2006-2009

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL 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. The 2005 reform of the Pact acknowledged its 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 policies¹, which is part of the Stability and Growth 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 in 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.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the stability programme of the Netherlands, submitted on 22 November 2006, and has adopted a recommendation for a Council opinion on it (see box for the main points covered by the assessment).

In order to set the scene against which the budgetary strategy in the updated stability programme is assessed, the following paragraphs summarise:

- (1) the economic and budgetary performance over the last ten years
- (2) the most recent assessment of the country's position under the preventive arm of the Stability and Growth Pact (summary of the Council opinion on the previous update of the stability programme) and
- (3) the Commission's assessment of the September 2006 national reform programme.

2.1. Recent economic and budgetary performance

During the second half of the 1990s, the Netherlands experienced a prolonged cyclical upswing and performed better on average than the euro area both in terms of economic

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

growth and unemployment. It was followed by a downturn in the early 2000s. Over this entire cycle, Dutch economic performance was better than the euro area average. However, a more stable growth pattern would probably have been beneficiary for the economy. The current very high private financial debt levels risk unwinding in case of further interest rate increases, which could dampen private consumption and thereby bring about the next economic downturn.

Furthermore, the strong developments in both housing and equity markets that played a large role in explaining the economic boom of the late 1990s also resulted in temporary increases in tax elasticities. The fiscal rules that were in place could not fully prevent the fiscal policy stance from turning out pro-cyclical. 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. A substantial budgetary consolidation was achieved in 2004 and in 2005, which reduced the deficit to 1.9% and 0.3% of GDP in 2004 and 2005, respectively. In June 2005 the Council abrogated the excessive deficit procedure that had been launched in June 2004.

2.2. The assessment in the Council opinion on the previous programme

On 14 March 2006, the Council adopted its opinion on the previous update of the stability programme, covering the period 2005-2008. The Council welcomed "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". It invited the Netherlands "also in view of better-than-expected results in 2005, [to] maintain a strong budgetary position in 2006 and thereafter".

2.3. The Commission assessment of the 2006 national reform programme

The Implementation Report of the National Reform Programme of the Netherlands, provided in the context of the renewed Lisbon strategy for growth and jobs, was submitted on 16 October 2006. The Dutch National Reform Programme identifies as key challenges/priorities: improving labour supply; achieving faster growth in labour productivity, in particular by strengthening R&D, innovation and education; and improving price competitiveness, in particular by containing labour costs.

The Commission's assessment (adopted as part of its December 2006 Annual Progress Report²) showed that the Netherlands is making good progress with the implementation of its National Reform Programme. While there are certain risks in the macro area, notably with regard to household indebtedness and potential wage inflation due to the tightening of the labour market, overall the policy framework is appropriate. Despite only moderate progress on R&D, the Netherlands is generally moving ahead significantly in the micro-economic field. Notwithstanding high headline employment rates for most groups, the picture in the employment field is more mixed.

Against the background of strengths and weaknesses identified, the Netherlands was recommended to take action to improve labour supply, notably of older workers, women and disadvantaged groups.

² Communication from the Commission to the Spring European Council, "Implementing the renewed Lisbon strategy for growth and jobs - A year of delivery" - COM(2006) 816, 12.12.2006 .

Box: Main points covered by the assessment

As required by Article 5(1) (for stability programmes) and Article 9(1) (for convergence programmes) of Council Regulation (EC) No 1466/97, the assessment covers the following points:

- whether the economic assumptions on which the programme is based are plausible;
- the medium-term budgetary objective (MTO) presented by the Member State and whether the adjustment path towards it is appropriate;
- whether measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the MTO over the cycle;
- when assessing the adjustment path towards the MTO, whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad times, and, for euro-area and ERM II Member States, whether the Member State pursues an annual improvement of the cyclically-adjusted balance, net of one-off and other temporary measures, of 0.5% of GDP as a benchmark to meet its MTO;
- when defining the adjustment path to the MTO (for Member States that have not yet reached it) or allowing a temporary deviation from the MTO (for Member States that have), the implementation of major structural reforms which have direct long-term cost-saving effects (including by raising potential growth) and therefore a verifiable impact on the long-term sustainability of public finances (subject to the condition that an appropriate safety margin with respect to the 3% of GDP reference value is preserved and that the budgetary position is expected to return to the MTO within the programme period), with special attention for pension reforms introducing a multi-pillar system that includes a mandatory, fully-funded pillar;
- whether the economic policies of the Member State are consistent with the broad economic policy guidelines.

The plausibility of the programme's macroeconomic assumptions is assessed by reference to the Commission services' autumn 2006 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. The assessment of consistency with the broad economic policy guidelines is made against the broad economic policy guidelines in the area of public finances as included in the integrated guidelines for the period 2005-2008.

The assessment also examines:

- the evolution of the debt ratio and the outlook for the long-term sustainability of the public finances, which should be given "sufficient attention in the surveillance of budgetary positions" according to the Council report of 20 March 2005 on "Improving the implementation of the Stability and Growth Pact". A Commission Communication of 12 October 2006 sets out the approach to the assessment of long-term sustainability³;
- the degree of integration with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs. In its cover note of 7 June 2005 to the European Council on the broad economic policy guidelines for the period 2005-2008, the ECOFIN Council stated that the national reform programmes should be consistent with the stability and convergence programmes;

compliance with the code of conduct⁴, which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

³ Communication from the Commission to the Council and the European Parliament, "The long-term sustainability of public finances in the EU" - COM(2006) 574, 12.10.2006 - and European Commission, Directorate-General for Economic and Financial Affairs (2006), "The long-term sustainability of public finances in the European Union", European Economy No 4/2006.

⁴ "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.

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**in accordance with the third paragraph of Article 5 of
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On the updated stability programme of the Netherlands, 2006-2009

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 policies⁵, 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 [27 February 2007] the Council examined the updated stability programme of the Netherlands, which covers the period 2006 to 2009.
- (2) The macroeconomic scenario underlying the programme envisages that real GDP will grow by 3¼% in 2006, 3% in 2007 and 1¾% per year over the rest of the programme period. Assessed against currently available information, this scenario appears to be based on plausible growth assumptions for 2006 and 2007 and cautious ones thereafter. The programme's projections for inflation appear realistic until 2007 and seem to be on the low side thereafter in light of the expected tightness of the labour market.
- (3) For 2006, the general government position is estimated to be balanced in the Commission services' autumn 2006 forecast, against a target of -1.5% of GDP set in the previous update of the stability programme. This mainly reflects a strongly improved cyclical outlook resulting in higher tax revenues as well as higher receipts from the sale of natural gas. Information that has become available since the autumn forecast (monthly data on the general government balance) points to an even better

⁵ 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

budgetary outcome. The latest official estimate, contained in the Autumn 2006 memorandum, puts the outturn for 2006 at a surplus of 0.4% of GDP.

- (4) The medium-term budgetary strategy in the programme aims at addressing the challenge of the cost of ageing through further fiscal consolidation. To this end, the programme projects the general government surplus to improve from 0.1% of GDP in 2006 to 0.9% in 2009. The primary surplus is targeted to improve from 2.4% of GDP in 2006 to 2.9% in 2009, which is fully concentrated in the final year of the programme, reflecting in large part the expected refunding in that year of the EU own resources contribution paid over the period 2007-2009. The nominal adjustment is fully explained by a fall in the expenditure-to-GDP ratio, which more than compensates a 0.2 percentage point decline in the revenue-to-GDP ratio. Compared to the previous update of the stability programme, the level of the general government balance is markedly higher throughout the programme period. This mainly reflects higher gas receipts, the improved macroeconomic situation in 2005 and outlook for 2006.
- (5) The structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology is expected to deteriorate by around half a percentage point of GDP in 2007, stabilise in 2008 and improve by around half a percentage point of GDP in 2009. As in the previous update of the stability programme, the medium-term objective (MTO) for the budgetary position presented in the programme is a structural deficit ranging from 0.5 to 1% of GDP, which the programme plans to maintain throughout the programme period. As the lower bound of the MTO range is equal to the minimum benchmark (estimated at a deficit of around 1% of GDP), achieving the MTO should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The MTO 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.
- (6) The risks to the budgetary projections in the programme appear broadly balanced from 2007 onwards. On the one hand, the possibility of a positive carry-over into 2007 of the higher tax receipts in 2006 constitutes a positive risk to the budgetary outcome in 2007. Furthermore, for 2008 and 2009, a positive risk to the budgetary position stems from the cautious macroeconomic scenario. On the other hand, gas receipts may turn out lower than currently anticipated throughout the period.
- (7) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the MTO throughout the programme period, as envisaged in the programme. In addition, it provides a sufficient safety margin against breaching the 3% of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme period. Nevertheless, there is a risk that the fiscal policy stance implied by the programme may turn out to be pro-cyclical in 2007, when good times are expected. This would not be in line with the Stability and Growth Pact.
- (8) Thanks to the sharp reduction in the general government deficit in 2004 and 2005, government gross debt is estimated to have fallen to 50.2% of GDP in 2006, further below the 60% of GDP Treaty reference value. The programme projects the debt ratio to further decline by 6 percentage points over the programme period.

- (9) The long-term budgetary impact of ageing in the Netherlands is higher than the EU average, influenced notably by a relatively high increase in pension expenditure as a share of GDP over the coming decades. The initial budgetary position, albeit not as strong as in 2005, contributes to easing the projected long-term budgetary impact of an ageing population, but it is not sufficient to fully cover it. The projected future rise of revenues as a share of GDP, mainly due to deferred taxation of pensions, would partly compensate for the increase in public expenditure over the long term. Ensuring high primary surpluses over the medium term and/or implementing reform measures that curb the projected increase in age-related expenditure would contribute to containing risks to the sustainability of public finances. Overall, the Netherlands appears to be at low risk with regard to the sustainability of public finances.
- (10) The stability programme does not contain a qualitative assessment of the overall impact of the 2006 implementation report of the national reform programme within the medium-term fiscal strategy. In addition, it provides no systematic information on the direct budgetary costs or savings of the main reforms envisaged in the national reform programme, although its budgetary projections seem to take into account the public finance implications of the actions outlined in the national reform programme. The measures in the area of public finances envisaged in the stability programme seem consistent with those foreseen in the national reform programme. In particular, both programmes describe the recent health care reform, the modifications to the corporate tax system and planned extra outlays, for instance on infrastructure.
- (11) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008.
- (12) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and most of the optional data⁶.

The overall conclusion is that the medium-term budgetary position is sound. An important risk is that the current high level of gas receipts may not persist but overall the risks attached to the achievement of the budgetary targets are broadly neutral.

In view of the above assessment and the good growth prospects, the Netherlands is invited to maintain a strong structural position in 2007 and beyond, thereby avoiding pro-cyclical fiscal policies in good times.

⁶ In particular, the functional breakdown of government expenditures for 2009 is missing.

Comparison of key macroeconomic and budgetary projections

		2005	2006	2007	2008	2009
Real GDP (% change)	SP Nov 2006	1.5	3¼	3	1¾	1¾
	COM Nov 2006	1.5	3.0	2.9	2.6	n.a.
	SP Dec 2005	¾	2½	2½	2¼	n.a.
HICP inflation (%)	SP Nov 2006	1.5	1½	1¾	1¾	1¾
	COM Nov 2006	1.5	1.6	1.8	2.3	n.a.
	SP Dec 2005	1.5	1.5	1.1	n.a.	n.a.
Output gap (% of potential GDP)	SP Nov 2006¹	-1.9	-0.5	0.6	0.6	0.3
	COM Nov 2006 ⁵	-2.0	-1.2	-0.4	0.0	n.a.
	SP Dec 2005 ¹	-2.3	-1.5	-0.9	-0.6	n.a.
General government balance (% of GDP)	SP Nov 2006	-0.3	0.1	0.2	0.3	0.9
	COM Nov 2006	-0.3	0.0	0.1	0.3	n.a.
	SP Dec 2005	-1.2	-1.5	-1.2	-1.1	n.a.
Primary balance (% of GDP)	SP Nov 2006	2.1	2.4	2.4	2.4	2.9
	COM Nov 2006	2.1	2.3	2.3	2.3	n.a.
	SP Dec 2005	1.4	1.1	1.4	1.5	n.a.
Cyclically-adjusted balance (% of GDP)	SP Nov 2006¹	0.8	0.4	-0.1	0.0	0.7
	COM Nov 2006	0.9	0.6	0.4	0.3	n.a.
	SP Dec 2005 ¹	0.0	-0.7	-0.6	-0.6	n.a.
Structural balance ² (% of GDP)	SP Nov 2006³	0.8	0.4	-0.1	0.0	0.4
	COM Nov 2006 ⁴	0.9	0.6	0.4	0.3	n.a.
	SP Dec 2005	0.0	-0.7	-0.6	-0.6	n.a.
Government gross debt (% of GDP)	SP Nov 2006	52.7	50.2	47.9	46.3	44.2
	COM Nov 2006	52.7	50.5	47.8	45.4	n.a.
	SP Dec 2005	54.4	54.5	53.9	53.1	n.a.

Notes:

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

² Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.

³ One-off and other temporary measures taken from the programme (0.3% of GDP in 2009; deficit-reducing).

⁴ There are no one-offs and other temporary measures in the Commission services' autumn 2006 forecast.

⁵ Based on estimated potential growth of 1.9%, 2.1%, 2.2% and 2.1% respectively in the period 2005-2008.

Source:

Stability programme; Commission services' autumn 2006 economic forecasts (COM); Commission services' calculations