EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 4 March 2009
ECFIN/ G2/09/50716-EN

THE NETHERLANDS: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE NOVEMBER 2008 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term budgetary programme, called "stability programme" for countries that have adopted the euro as their currency and "convergence programme" for those that have not.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 18 February 2009. Comments should be sent to Maarten Masselink (Maarten.Masselink@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' January 2009 interim 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) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. Technical issues are explained in an accompanying methodological paper prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 18 February. The ECOFIN Council is expected to adopt its opinion on the programme on 10 March 2009.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

1. INTRODUCTION

This document assesses the November 2008 update of stability programme of the Netherlands. It takes into account all currently available information, notably the Commission services' January 2009 interim forecast and the short-term fiscal stimulus measures adopted by the Dutch government in response to the economic downturn.[1] The programme covers the period 2008-2011. It was agreed upon within the Council of Ministers and was submitted to the Dutch Parliament and the Commission and the Council on 28 November 2008[2]. An addendum to the programme was submitted on 19 December 2008. It details the short-term measures in response to the economic downturn and also contains the macroeconomic projections as provided by the CPB Netherlands Bureau for Economic Policy Analysis in December 2008.

2. MAIN CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

In 2008, economic activity slowed down considerably as the global economic downturn and the financial crisis hit both external and domestic demand. While annual growth still reached 1.9%, this was largely due to the exceptionally strong domestic demand in the second half of 2007 and the carry-over effect. Private consumption provided only limited support to economic growth in 2008, as disposable income was weakened by increasing inflation and rises in taxes and social premiums. Furthermore, net exports put a drag on growth as investments in airplanes and energy projects in the first half of 2008 led to a considerable increase in imports. The labour market still held up well, with unemployment falling until the end of 2008. According to the Commission services' calculations, the output gap was not yet affected by the downturn and remained positive. However, for 2009 and 2010 the output gap is expected to decrease rapidly and to turn negative, as economic activity is expected to decrease sharply in 2009 and to only show a small increase of 0.2% in 2010. As the economic crisis is deepening, unemployment is expected to increase in the course of 2009 by over 1 percentage point to 4.1% and further to 5.5% in 2010. Against this background, the economy seems to be entering bad economic times in 2009 and 2010 as can be seen in Figure 1 in Annex 2.

The global economic downturn and the financial crisis affect economic activity through the trade channel as well as through domestic demand. Having a very open economy, with total trade flows (exports plus imports) amounting to 140% of GDP in 2007, the Netherlands is particularly exposed to the downturn in world trade. Exports are expected to decrease by 3½% in real terms in 2009, according to the Commission services' January 2009 interim forecast. Imports are foreseen to go down by 2½%. On balance, net exports should provide a negative contribution to GDP growth. As a result, the current account surplus is expected to deteriorate. Nevertheless, with a surplus of around 10% in 2007, the starting position of the Dutch current account is very sound. Despite the economic downturn and the projected loosening of the labour market, wages are expected to increase by 3¼% in 2009. This is because wage agreements have in large part already been set, reflecting higher inflation

[1] It does not take into account, however, the most recent CPB forecast of February 2009.

[2] Only an English version was submitted.

expectations and a tighter labour market. The relatively high wage increase in 2009 is assumed to have a negative effect on competitiveness. However, for 2010, it is expected that the increase in unemployment will lower wage demands significantly. The financial sector in the Netherlands was badly hit by the financial crisis, which resulted in multiple government interventions in the financial markets. Liquidity and lending conditions have been tightened in the course of 2008. This is expected to have an impact on private consumption, which will also be affected by considerable negative wealth effects from the fall in stock prices and continuing negative consumer confidence. Investment is also likely to decrease sharply in 2009, because of a drop in both domestic and external demand, and because of increasing difficulties in gaining access to finance due to tightening credit conditions.

Taking into account the relatively good starting point, with a high current account surplus, a tight labour market and a relatively limited wage growth over the past years, the medium-term outlook is still favourable for the Netherlands. In the near term, however, the financial crisis poses a major challenge. First of all, the very low confidence in the financial sector should be addressed, as this is increasingly putting pressure on access to finance. Furthermore, the shock to the financial system has hit the pension funds, mostly through the sharp drop in share prices. With total assets of approximately 130% of GDP at the end of 2007, they are a key instrument with respect to the strategy of pre-financing the costs of ageing. It will be important to improve the asset positions of the pension funds in the near term, without at the same time affecting disposable income too much.[3]

The budgetary situation is at a relatively good starting point in 2008. Since 2006, the government balance has recorded a surplus position. For 2009 and 2010 a quick deterioration of the government balance is expected. Government debt has been well below the 60% threshold over the past years. Despite the government operations to stabilise the financial markets amounting to around 15% of GDP[4], debt is expected to stay below this threshold. Currently, the Netherlands is assessed as having a large fiscal space.

In December, the Dutch government introduced a recovery plan to counteract the economic downturn. The recovery plan is expected to have a limited impact on growth and the budget (see Section 4.2). The most relevant measures included in the recovery plan can be summarized as follows:

- Accelerated depreciation for investments: companies have the option to write off investments taking place in 2009 in two years instead of three.
- Tax cuts for SME's: profits up to €200 000 will be taxed at 20% instead of at 23% in 2009 and 2010.
- Stimulation of the provision of credit for SME's: in order to improve the access to finance for SME's, the guarantee scheme for SME's is expanded.
- Working hours reduction: companies facing a temporary and sharp fall in demand can ask for a decrease in working hours of employees, for which employees get unemployment benefits (70%) from the government, which is then topped up by the company to 100%.

[3] During the last downturn in 2001-2002 the asset position of pension funds also deteriorated quickly, triggering a sharp increase in premiums, which prolonged the downturn by depressing private consumption through lower disposable income.

[4] For more details on the government operations, see paragraph 4.1.

- Accelerated public administration debit payments: the Dutch government is reducing the delay in paying its bills.

In addition to the recovery plan as presented in the addendum, the Netherlands adopted a second stimulus package in January, which mainly consists of guarantees. These include an increase in the supply of export credit guarantees, guarantees to housing corporations and in bank lending guarantees.

The update of the stability programme also includes a series of structural measures, which are part of the longer-term policy reform agenda, and are therefore not presented as a response to the worsening of economic conditions, but help in any case to address the current challenges posed by the downturn. The lowering of social contributions aims at boosting demand, while increasing labour supply at the same time. Furthermore, in order to reduce labour shedding and to ease the transition in the labour market, mobility centres are set up, which are based on public-private partnerships. These measures are related to the medium-term reform agenda and the country-specific recommendation proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs.

Measures to help stabilise the financial system

With a view to stabilising the financial system, the Dutch government has adopted a number of measures. First, it increased the amount covered by the deposit guarantee scheme to €100.000. Second, a credit guarantee scheme amounting to €200 billion (33% of GDP) for medium-term debt instruments by banks was introduced. The scheme is aimed at improving their access to finance. Third, a fund of €20 billion (3.3% of GDP) was created to be used for recapitalisation of financial institutions. Finally, the government nationalised a major bank and provided an illiquid asset back-up facility to a large financial institution. This back-up facility is a specific guarantee with respect to the securitised mortgage portfolio of this institution. The Dutch state shares for 80% in the profits and losses resulting from this portfolio.

3. MACROECONOMIC SCENARIO

The stability programme projects a slowdown of economic growth in 2009 to 1¼%, down from 2¼% in 2008. A recovery is foreseen in 2010, with GDP growth of 2%.[5] In 2009, the programme expects the slowdown to be mainly caused by lower growth in domestic demand, especially investment. A pick-up of investment growth in 2010 is the main driver behind the projected recovery. The coverage of the alternative scenarios presented in the stability programme and the addendum is limited to such a degree that the original scenario of the stability programme is used for the assessment. The updated information from the addendum is referred to if and when possible.

GDP growth assumptions in the baseline scenario of the programme are markedly favourable in 2009 and 2010, where the Commission services' January 2009 interim forecast for GDP growth is approximately 3¼ and 1¾ percentage points lower, respectively. With regard to the

[5] The programme indicates that from 2010 the medium-term scenario was used, as developed by the Netherlands Bureau for Economic Policy Analysis (Centraal Planbureau/CPB) and published in 2007.

components, both domestic and external demand are markedly favourable when compared to the Commission services' forecast. In the addendum to the programme, an update of GDP growth figures is presented, with GDP growth in 2009 and 2010 estimated at – ¾% and 1% respectively. These figures are more in line with the Commission services' forecast, but remain favourable.

Over the programme period, the output gap, as recalculated by Commission services based on the information in the programme, following the commonly agreed methodology, is expected to decrease by 1½ percentage points. The Commission services' January 2009 interim forecast shows a markedly faster and deeper decrease in the output gap, leading to a negative output gap of 2¼% in 2010.

Labour productivity growth in the programme is expected to increase from ¼% to 1¼% over the programme period. Especially for 2009, this is markedly favourable, as the Commission services forecast productivity to decrease by 1.8%. This difference mainly stems from the favourable growth assumptions in the programme, which more than fully compensate the 1-pp higher employment growth. For 2010, when productivity growth is broadly in line with the Commission services projection, the favourable growth assumptions are matched by the higher employment growth.

The impact of fiscal stimulus measures in response to the downturn are incorporated in the alternative scenario presented in the addendum to the programme, but not in the baseline macro-economic scenario of the programme. In the addendum, the budgetary impact of the fiscal stimulus measures is assessed at less than 0.2% of GDP both in 2009 and in 2010, which seems plausible.

Table I: Comparison of macroeconomic developments and forecasts

	2008		2009		2010		2011
	COM	SP	COM	SP	COM	SP	SP
Real GDP (% change)	1.9	2¼	-2.0	1¼	0.2	2	2
Private consumption (% change)	1.3	1½	-0.7	1	0.3	1¼	1¼
Gross fixed capital formation (% change)	6.9	4½	-3.6	-1	-2.0	2	2
Exports of goods and services (% change)	3.8	3¾	-3.5	2¾	1.6	5¾	5¾
Imports of goods and services (% change)	5.2	3¾	-2.4	2½	1.6	5½	5½
Contributions to real GDP growth:							
- Final domestic demand	2.3	1.9	-0.6	0.8	0.0	1¼	1¼
- Change in inventories	0.2	0.1	-0.2	0.0	0.0	0	0
- Net exports	-0.6	0.3	-1.1	½	0.1	½	½
Output gap[1]	2.1	0.7	-1.2	-0.1	-2.2	-0.5	-0.6
Employment (% change)	1.8	2	-0.7	½	-1.3	½	½
Unemployment rate (%)	2.9	4	4.1	4¼	5.5	3	3
Labour productivity (% change)	0.1	¼	-1.8	¾	1.2	1¼	1¼
HICP inflation (%)	2.2	2½	1.9	3¼	1.8	2	2
GDP deflator (% change)	2.5	2¼	1.8	3½	1.9	1¾	1¾
Comp. of employees (per head, % change)	3.5	4¼	3.3	4	1.9	3½	3½
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.7	8.5	5.9	9.5	5.4	7.5	8.0

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source:

Commission services' January 2009 interim forecasts (COM); Stability programme (SP)

4. BUDGETARY STRATEGY

4.1. Budgetary implementation in 2008

In the November update of the stability programme, the general government balance in 2008 is estimated at a surplus of 1.2% of GDP. This is broadly in line with the latest Commission services' January 2009 interim forecast, which forecasts a budgetary surplus of 1.1% of GDP. However, the update also refers to the Ministry of Finance's 2008 Autumn Memorandum ("Najaarsnota"), which projects a surplus of 1.1% of GDP,[6] i.e. slightly lower than in the programme and fully in line with the most recent Commission services' forecast. The addendum to the stability programme of late December mentions a new surplus estimate of 1.3% of GDP, but states that this number is not officially endorsed by the Ministry of Finance.

The 0.6% of GDP better outturn for the government balance in 2008 (in the Commission services' January 2009 interim forecast) compared to the plans in the previous update can be almost fully explained by a 0.7% of GDP better-than-anticipated starting position at the end of 2007, as a result of 1% of GDP lower expenditure and 0.3% of GDP lower revenue. This

6 Although the programme explicitly refers to these figures that were made available before the programme was submitted, they are not incorporated in the programme's tables.

better starting position is slightly offset by a worse outcome of revenue and expenditure growth in 2008 of 0.1% of GDP.

Specifically, total revenue for 2008 is expected to be 0.1% of GDP lower than projected in the previous update of the stability programme. Apart from the above-mentioned base effect of -0.3%, this reflects somewhat stronger dynamics in revenues in 2008 as higher revenue from income taxes and gas revenue more than compensated the lower revenue from corporate taxes. The latter seems to have been a result of the financial crisis.

Overall, total government expenditure is projected to be 0.7% of GDP lower than anticipated in the previous programme. Besides the base effect of 1% of GDP, this can be explained by 0.2% higher-than-expected expenditure growth rate for 2008, mainly coming from higher interest payments and child care expenditure.

Several bank rescue operations by the Dutch government led to a significant increase in the gross public debt. The effects of the operations on the government balance were negligible in 2008 (see Section 5.1 for further details).

4.2. Near-term budgetary strategy

In the stability programme, the government balance is expected to stay at a surplus of 1.2% in 2009. Both revenue and expenditure are expected to decrease by 0.3% of GDP. For 2010, the budget balance is foreseen to worsen to 0.8% of GDP, reflecting a further decline in revenue and an increase in expenditure[7]. The budgetary projections for 2009 in the programme are fully in line with the budget for 2009, which was sent to Parliament on 17 September 2008. In the addendum to the stability programme the recovery plan is presented. It incorporates additional deficit increasing measures, which are not included in the 2009 budget, or in the stability programme update. The addendum points to general budget deficits of 1.2% in 2009 and 2.4% in 2010, again without officially endorsing them. These numbers are markedly worse than the expected surplus position contained in the stability programme. By not endorsing these updated budgetary figures, the status of the Dutch budgetary targets is unclear. All relevant budgetary measures from both the stability programme and the addendum are presented in table II.

The main budgetary measure of the recovery plan, as presented in the addendum to the stability programme, concerns the accelerated depreciation of investment, which gives companies the option to write off investments taking place in 2009 in two years instead of three. This translates into a tax cut for companies in 2009 and 2010 of less than 0.2% of GDP in both years. This measure is in line with the general principles set out in the Commission Communication of 26 November 2008 on the European Economic Recovery Plan as it is a temporary, timely and targeted measure. First, it is temporary as only investments made in 2009 are eligible. Second, it is timely as it should affect growth in 2009. Third, it is targeted as it is meant to boost domestic demand.

The stability programme itself does not include an overview of planned measures for 2009. This complicates the analysis of the relevant budgetary measures. Although some of them are mentioned in the programme, there is almost no information on the budgetary impact of these

[7] The data of 2010 are not fully updated, but are based on the medium-term scenario, which dates back to 2007. Therefore, it is not possible to make a detailed analysis of changes in revenue and expenditure from 2009 to 2010.

measures. On the revenue side, the exception is the introduction of the income based combination tax credit, which is meant to encourage people with a small part-time job to work more hours, which should lower government revenue by 0.1% of GDP. Based on the 2009 budget other relevant measures are an increase in excise duties (0.1% of GDP) and in income tax (0.1% of GDP). Furthermore, the deductibility of exceptional expenses will be abolished, increasing revenue by 0.1% of GDP in 2009. On the other hand, health care premiums are lowered by 0.1% of GDP and the unemployment insurance premium is reduced by about 0.3% of GDP. Finally, corporate taxes will be lowered by 0.1% of GDP in 2009.

On the expenditure side, the programme also does not provide a comprehensive and consistent view of expenditure developments. It only provides a global overview of the expenditure increase in six priority areas, which the government indentified upon taking office in February 2007. These areas constitute the total expenditure impulses in both 2008 and 2011, which are 0.5% and 1.1% of GDP, respectively. However, for 2009 and 2010 no specific information is available on the evolution of the expenditures in these priority areas. Furthermore, there is no information available on expenditure cuts. When combining the 2008 and 2009 budgets, the two main budgetary measures on the expenditure side in 2009 seem to be an increase of 0.3% in education and a 0.2% increase in infrastructure projects.

In the programme a positive one-off measure is presented in 2009, which is related to the reduction in the annual contribution of the Netherlands to the EU budget 2007-2013 according to the Council decision on the EU own resources. This is expected to yield a structural benefit for the government balance of a little under 0.2% of GDP. As the Council decision will enter into force retroactively from 1 January 2007, retributions for the period 2007-2008 are paid out in 2009, leading to a positive one-off of approximately 0.3% of GDP in 2009, which comes on top of the reduction in the annual contribution for 2009. This is fully in line with the Commission services' January 2009 interim forecast.

In 2008, the structural balance in the programme, as recalculated by the Commission's services according to the commonly agreed methodology, shows a marked improvement from a deficit of 0.8% in 2007, to a surplus of 0.8%. In 2009, the structural balance is expected to improve slightly to 1.0% of GDP. This means that the planned fiscal stance of fiscal policy in 2009 as presented in the November 2008 update of the stability programme can be characterised as mildly restrictive. Of course, this assessment does not take into account the updated information regarding expected lower growth and the budget deficits in 2009 and 2010. Based upon these figures, the structural balance would most likely deteriorate in both 2009 and 2010, which would correspond to an expansionary fiscal stance.

Table II. Main budgetary measures for 2009

Revenue measures[1]	Expenditure measures[2]
Measures in response to the downturn	
• Accelerated depreciation for investments (-0.2% of GDP)	
Other measures	
• Reduction in social contributions (-0.3% of GDP) • Lower health care premiums (-0.1% of GDP) • Income based combination tax credit (-0.1% of GDP) • Lower corporate taxes (-0.1% of GDP) • Increase in excise duties (0.1% of GDP) • Exceptional expenses deductible (0.1% of GDP)	• Increase in education expenditures (0.3% of GDP) • Increase in infrastructure projects (0.2% of GDP)

Note:

[1] Estimated impact on general government revenue.

[2] Estimated impact on general government expenditure.

Source: Commission services and the 2008 and 2009 Budget memoranda.

The recovery plan as presented in the addendum to the stability programme also includes a number of measures with a limited (direct) budgetary impact which are aimed at providing stability in the financial sector or a short-term boost to the economy. First of all, in order to improve the access to finance for SME's, the guarantee scheme for SME's is expanded. In addition, companies facing a temporary and sharp fall in demand can request to cut down working hours of employees. Total cost of this measure is capped at €200 million (or 0.03% of GDP).

On 16 January, the Dutch government announced a second support package. It focuses on increasing the supply of credit and consists mainly of guarantees. The direct budgetary impact of these measures is therefore expected to be negligible. The main measure of this new package is the introduction of a government guarantee for bank lending to companies of loans up to €50 million and a total maximum amount guaranteed of €1.5 billion (¼% of GDP). Other measures include an increase in the supply of export credit guarantees and in guarantees to housing corporations.

Table III: Composition of the budgetary adjustment

(% of GDP)	2007	2008		2009		2010		2011	Change: 2008-2011
	COM	COM	SP	COM	SP	COM[1]	SP	SP	SP
Revenue	**45.6**	**46.8**	**46.6**	**46.1**	**46.3**	**45.6**	**46.1**	**46.3**	**-0.3**
of which:									
- Taxes on production and imports	12.6	12.5	12.7	12.7	12.7	12.6	12.7	12.6	-0.1
- Current taxes on income, wealth, etc.	12.0	12.6	12.6	12.4	12.6	12.4	12.5	12.3	-0.3
- Social contributions	14.3	14.5	14.5	14.1	14.1	14.1	14.5	15.0	0.5
- Other (residual)	6.8	7.2	6.8	6.8	6.9	6.6	6.4	6.4	-0.4
Expenditure	**45.3**	**45.7**	**45.4**	**47.4**	**45.1**	**48.3**	**45.3**	**45.2**	**-0.2**
of which:									
- Primary expenditure	43.1	43.3	43.2	44.8	43.0	45.8	43.2	43.2	0.0
of which:									
Compensation of employees	9.2	9.1	9.2	9.5	9.3	9.5	9.3	9.3	0.1
Intermediate consumption	7.2	6.9	7.2	7.3	7.2	7.4	7.2	7.2	0.0
Social payments	20.0	20.2	20.0	21.1	19.6	21.5	19.8	19.8	-0.2
Subsidies	1.3	1.2	1.3	1.3	1.3	1.3	1.3	1.3	0.0
Gross fixed capital formation	3.3	3.4	3.4	3.6	3.5	3.6	3.5	3.5	0.1
Other (residual)	2.1	2.4	2.1	2.1	2.1	2.5	2.1	2.1	0.0
- Interest expenditure	2.2	2.3	2.2	2.6	2.1	2.5	2.1	2.0	-0.2
General government balance (GGB)	**0.3**	**1.1**	**1.2**	**-1.4**	**1.2**	**-2.7**	**0.8**	**1.1**	**-0.1**
Primary balance	**2.6**	**3.5**	**3.4**	**1.2**	**3.3**	**-0.2**	**2.9**	**3.1**	**-0.3**
One-off and other temporary measures	0.0	0.0	0.0	0.3	0.3	0.0	0.0	0.0	0.0
GGB excl. one-offs	**0.3**	**1.1**	**1.2**	**-1.7**	**0.9**	**-2.7**	**0.8**	**1.1**	**-0.1**
Output gap[2]	2.1	2.1	0.7	-1.2	-0.1	-2.2	-0.5	-0.6	-1.4
Cyclically-adjusted balance[2]	-0.8	0.0	0.8	-0.7	1.3	-1.5	1.1	1.5	0.7
Structural balance[3]	**-0.8**	**0.0**	**0.8**	**-1.0**	**1.0**	**-1.5**	**1.1**	**1.5**	**0.7**
Change in structural balance		*0.8*	*1.6*	*-1.0*	*0.2*	*-0.5*	*0.1*	*0.4*	
Structural primary balance[3]	1.4	2.3	3.0	1.6	3.1	1.0	3.2	3.5	0.5
Change in structural primary balance		*0.9*	*1.6*	*-0.7*	*0.1*	*-0.6*	*0.1*	*0.3*	

Notes:

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability programme (SP); Commission services' January 2009 interim forecasts (COM); Commission services' calculations

4.3. Medium-term budgetary strategy

The main goal of the programme's budgetary strategy is to attain a structural surplus of 1% of GDP at the end of the planned government term in 2011, which is well above the Medium-Term Objective of a structural deficit ranging from -0.5% to -1% of GDP, which is unchanged since the previous programme update.

Regarding the time profile of the adjustment path, the programme expects a nominal budget surplus of 1.2% of GDP in 2008 and in 2009, falling to 0.8% of GDP in 2010 and coming out at 1.1% of GDP in 2011. The primary balance is expected to follow a similar pattern. According to the indications provided in the December 2008 addendum, the headline balance in 2009 and 2010 is now considered to be markedly less optimistic (-1.2% and -2.4%

respectively), which also suggests that the planned balance for 2011 may be outdated. Again, it is not clear what exactly the (medium-term) budgetary targets are.

According to the programme, the structural balance, as recalculated by the Commission's services according to the commonly agreed methodology, is expected to improve to a surplus of 1.5% of GDP in 2011, coming from a surplus of 0.8% of GDP in 2008, 1.0% of GDP in 2009 and 1.1% of GDP in 2010. As such, the fiscal policy is mildly restrictive over the programme period. In the addendum there is no update of the structural balance and data provided is not sufficient to recalculate it using the commonly agreed methodology. The Commission services' January 2009 interim forecast projects the structural balance to decrease by 1% of GDP in 2009 and another 0.5% in 2010 to reach -1.5% of GDP in 2010. This would imply that the MTO was not attained for the first time since 2005 in a context of strong cyclical downturn.

4.4. Risks to the budgetary targets

The government surplus presented in the programme for both 2009 and 2010, which is markedly more favourable than the deficit positions expected in Commission services' January 2009 interim forecast, points to a significant downward risk to the general budget. In the addendum, this is already acknowledged, although the figures which are mentioned there are not endorsed by the Ministry of Finance and are still on the optimistic side.

The risk first of all stems from the fact that the macro-economic scenario as presented in the stability programme is based on markedly favourable growth assumptions. In the programme, GDP growth is assumed to be 1¼% in 2009 and 2% in 2010. The addendum to the stability programme already presents a much more pessimistic view of GDP growth, posting -¾% in 2009 and 1% in 2010; however, the economic situation is likely to turn out to be even considerably worse than this update. As mentioned earlier, according to the Commission services' January 2009 interim forecast, GDP will decline by 2.0% in 2009 and increase by only 0.2% in 2010.

In the Commission services' January forecast, the ratio of overall tax revenue to GDP decreases by about ¾ percentage points in 2009, which stems from an overall tax cut, from the economic downturn pushing down tax elasticities and from a decrease in corporate taxes as profits from financial institutions have fallen sharply. In the programme this ratio also decreases, but only by ¼ percentage point in 2009. For 2010, the decrease in the tax-to-GDP ratio in the programme is also smaller than in the Commission services' forecast. The primary reason for this difference is the hypothesis regarding tax elasticities, which are assumed to be higher in the stability programme and thereby presenting another source of possible downward revision to the target.

The Dutch budget strongly relies on gas revenues. Such revenues are known to be volatile, mostly because of possible large movements in oil prices and the euro-dollar exchange rate. The volatility of gas revenues and the resulting budgetary risks have already been highlighted in the previous macro fiscal assessment. As gas revenues in the programme are based on a more optimistic oil price hypothesis (of $125 in 2009), this constitutes a high risk for the government balance especially in 2009.

In the programme, expenditure is foreseen to decrease by ¼% of GDP. This would imply that the expenditure ceiling would be respected. Although the Dutch government has a good track record, in the context of the current downturn it may prove difficult to maintain it. This is reinforced by the fact that some expenditure components under the ceiling are cyclical, like part of the social security expenditures. Furthermore, in view of a more pronounced economic downturn than expected and in response to the European Economic Recovery Plan the government may decide to undertake additional stimulus measures.

The role of one-off and other temporary measures is insignificant over most of the programme horizon. Merely the refunding in 2009 of EU contributions paid over the period 2007-2008 amounting to 0.3% of GDP can be considered as a relevant one-off.

Overall, the budgetary outcomes are subject to (significant) downside risks. These risks are predominantly due to the implausible macro-economic assumptions in the programme against the background of the impact of the financial crisis.

The government operations to stabilise the financial markets pose a significant risk for the government balance from 2009. In 2008, the government set up a € 20 billion (3% of GDP) fund, which is meant for strengthening the capital position of financial institutions. Up until now almost € 14 billion of this fund is used. Furthermore, the government set up a € 200 billion (33% of GDP) credit guarantee scheme for financial institutions. Although the use of this scheme has been rather limited up until now, there are possible future budgetary risks.

The recovery plans of the government also pose a budgetary risk, especially where they concern guarantees. This has been further reinforced by the guarantee issued to ING of approximately € 27.7 billion (or about 5% of GDP). Because of the uncertainty to what extent these guarantees will be called upon, it is not possible to determine the ultimate budgetary risk coming from all these operations.

5. DEBT DEVELOPMENTS AND LONG-TERM SUSTAINABILITY

5.1. Debt developments

At the end of 2007, the debt-to-GDP ratio stood at 45.7%. Despite an expected budgetary surplus, the debt ratio has risen significantly to about 57% of GDP in 2008, because of several bank rescue operations by the Dutch government. The purchase of the shares of Fortis Bank Netherlands, Fortis Insurance Netherlands and Fortis Corporate Insurance increased the debt by 2¾% of GDP. The Dutch government also provided Fortis Bank Netherlands with a short- and long-term loan, which amounted 8½% of GDP. Furthermore, three financial institutions received capital injections totalling 2¼, of GDP.

The programme, which did not yet take into account the financial rescue operations by the government, expects the gross debt-to-GDP ratio to decline from 42.1% in 2008 to 38% in 2010 and further to 36.2% in 2011, owing to a continuous surplus of the primary balance. The programme differs markedly from the Commission services' January 2009 interim forecast, which foresees a stabilisation in 2009 and 2010 to about 53% and 55%, after the initial rise in 2008. In the addendum to the stability programme a debt-to-GDP ratio of around 57% for 2008 is presented, which includes the government operations to stabilise the financial markets. This is in line with the Commission services' forecast.

Risks to the debt level stem in large part from the €200 billion (33% of GDP) credit guarantee scheme for financial institutions, as well as the separate guarantee for ING. Although, up until now only limited use has been made of this credit guarantee scheme by financial institutions, there is a considerable upward risk to government debt in case this will increase over the course of 2009. If called upon, these guarantees will add to the debt through the budget deficit.

A further risk to government debt is the possibility of a higher-than-foreseen budget deficit. Alone the higher deficit for 2009 and 2010 in the Commission services' January 2009 interim forecast compared to the stability programme would imply a 6.1% higher government debt ratio in 2010 than the programme.

Table IV: Debt dynamics

(% of GDP)	average 2002-06	2007	2008		2009		2010		2011
			COM	SP	COM	SP	COM	SP	SP
Gross debt ratio[1]	**50.8**	**45.7**	**57.3**	**42.1**	**53.2**	**39.6**	**55.2**	**38.0**	**36.2**
Change in the ratio	-0.7	-1.8	11.6	-3.6	-4.0	-2.5	2.0	-1.6	-1.8
Contributions [2] *:*									
1. Primary balance	**-1.1**	**-2.6**	**-3.5**	**-3.4**	**-1.2**	**-3.3**	**0.2**	**-2.9**	**-3.1**
2. "Snow-ball" effect	**0.6**	**0.0**	**0.4**	**0.4**	**2.7**	**0.4**	**1.5**	**0.7**	**0.6**
Of which:									
Interest expenditure	2.5	2.2	2.3	2.2	2.6	2.1	2.5	2.1	2.0
Growth effect	-0.8	-1.6	-0.8	-1.0	1.1	-0.5	-0.1	-0.8	-0.7
Inflation effect	-1.1	-0.7	-1.1	-0.9	-1.1	-1.2	-1.0	-0.7	-0.6
3. Stock-flow adjustment	**-0.1**	**0.9**	**14.6**	**-0.5**	**-5.5**	**0.4**	**0.3**	**0.6**	**0.7**
Of which:									
Cash/accruals diff.	0.3	0.1		0.2		0.2		0.0	0.1
Acc. financial assets	-0.4	0.8		-0.5		-0.1		0.1	-0.1
Privatisation	0.0	-0.1		0.0		0.0		0.0	0.0
Val. effect & residual	0.0	0.0		-1.9		-1.9		-1.1	-1.0

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Stability programme (SP); Commission services' January 2009 interim forecasts (COM); Commission services' calculations

5.2. Long-term sustainability

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2006 according to an agreed methodology.[8]

Table 3 in Annex 2 shows that the projected increase in age-related spending is rising by 5.2% of GDP between 2010 and 2050, above the EU average. Sustainability indicators for two scenarios are presented in Table 4 in Annex 2. Including the increase of age related

8 Economic Policy Committee and the European Commission (2006), 'The impact of aging on public expenditure: projections for the EU-25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-50)', *European Economy − Special Report* No. 1/2006. European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006. European Commission (2008), *Public finances in EMU – 2008, European Economy* No. 4/2008.

expenditure and assuming that the structural primary balance remained at its 2008 level, the sustainability gap (S2)[9] would amount to 2.6% of GDP; about 1¼ percentage points of GDP less than in last year's assessment, which is due to an improvement in the estimated structural primary balance in the starting year. This starting budgetary position would be sufficient to stabilize the debt ratio over the long-term and to partly offset the long-term budgetary impact of ageing. However, if the 2009 budgetary position of the Commission services' January 2009 forecast was taken as the starting point, the sustainability gap would widen to about 4¼% of GDP.

The "programme scenario", which foresees some budgetary consolidation and is based on the end-of-programme structural primary balance, shows a smaller gap than the "2008 scenario". It must be noted, however, that both scenarios do not appropriately reflect the impact of the current crisis on public finances (see Sections 4.2- 4.4).

Based on the assumptions used for the calculation of the sustainability indicators, Figure 4 in the Annex 2 displays the projected debt/GDP ratio over the long-term.

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account. They are summarized in Table 5 in the Annex 2.

The long-term budgetary impact of ageing is higher in the Netherlands than the EU average. The projected future rise of tax revenues as a share of GDP, due to the deferred taxation of private pensions, would partly compensate the increase in public expenditure over the long term. The budgetary position in 2008 as estimated in the programme, which is better than the starting position of the previous programme, contributes to offsetting the projected long-term budgetary impact of an ageing population but is not sufficient to fully cover future spending pressures. Higher primary surpluses over the medium term, and implementing reform measures that curb the projected increase in age-related expenditure would contribute to reducing the medium risks to the sustainability of public finances. The above-mentioned risks from the financial sector stabilisation schemes (e.g. recapitalisation, guarantees) put in place by the Netherlands could have a potential negative impact on the long-term sustainability of public finances, primarily via their impact on government debt, although some of the costs of the government support could be recouped in the future.

6. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

In 1994, the Netherlands introduced a trend based budgetary framework, which is considered to be an efficient and effective budgetary framework.[10] While this framework was reaffirmed by the current government, some minor adjustments were made at the start of the government term in 2007.[11] More recently, however, a new fiscal rule was introduced, reflecting the government's operations to stabilise the financial markets. This new fiscal rule states that

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[9] The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

[10] For a description of the budgetary framework see Annex 1.

[11] For a description of these measures, see the Macro-Fiscal assessment of the Stability Programme of the Netherlands (Update of November 2007), Section 6.

expenditure and non-tax revenues resulting from the interventions in the financial sector will not be part of the expenditure ceiling[12]. Furthermore, if, as a consequence of these government operations, the signal value for the deficit of 2% of GDP, at which measures to increase revenue or reduce expenditure would normally be called for, were be reached[13], the rule would not be applied. This additional budgetary rule is meant to minimize the impact on normal budgetary decision-making of the measures taken in response to the financial crisis. As there is no end date set for this change in rules, it is likely to remain in place throughout the programme period.

Furthermore, the government announced a reform of the methodology with respect to the budgetary treatment of non-tax gas revenues starting from 2012. Until 2011 (the end of this programme period) the current method will be maintained. This means that a nominal amount of non-tax gas revenues, which can be used for spending through the Fund for Economic Structure Enhancement (Fonds Economische Structuurversterking/FES), is fixed for the entire period 2008-2011. Therefore, fluctuations in non-tax gas revenues will (a priori) lead to a change in the government balance.

7. ASSESSMENT

This section assesses the budgetary strategy, taking into account risks, in the light of (i) the adequacy of the fiscal stimulus package and the overall fiscal stance; (ii) the criteria for short-term action laid down in the Commission Communication of 26 November 2008 on the European Economic Recovery Plan (EERP) as endorsed by the European Council conclusions on the European Economic Recovery Plan (EERP) on 16 December 2008; (iii) the objectives of the Stability and Growth Pact.

(i) The direct budgetary impact of the short-term measures taken in response to the economic downturn is projected to be less than 0.2% of GDP both in 2009 and in 2010.[14] This is very limited with a view to the fiscal space and the strength of the downturn, as the Netherlands have been assessed to have a large fiscal space, the projected contraction of 2% of GDP and given the large commitments on the financial rescue packages. Among others the large fiscal space results from the fact that gross government debt, including potential government contingent liabilities to the financial sector, is projected to stay below 60%. Furthermore, the government balance shows a very good starting position in 2008 with a balanced structural budget according to the Commission services' January 2009 interim forecast. Also, the current account is expected to present a significant surplus in 2008, presenting a good basis for the remaining programme period.

The fiscal stance, as measured by the change in the structural balance and taking into account the risks, is expected to be expansionary in 2009, with a projected deterioration of about 1% of GDP. Apart from the short-term fiscal stimulus measures, this is mainly due to the impact of automatic stabilisers and a decline in gas revenues. The expansionary fiscal stance in 2009 seems to be appropriate when considering that the Netherlands is entering economic bad

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12 Expenditure ceilings in the Netherlands consist of expenditure and non-tax revenues.

13 Once the signal value for the budget deficit of currently 2.0% of GDP is reached, measures have normally to be taken in order to prevent an excessive deficit from happening.

14 This does not take into account the lowering of social contributions of 0.3% of GDP, which was decided before the first Dutch stimulus package.

times. For 2010 there are further downward risks to the structural balance, which could negatively affect the sustainability of public finances, if left unattended. On the other hand, long-term sustainability is expected to benefit somewhat from planned measures to further increase labour participation, such as the phasing out of the transferability of the general tax credit and the introduction of an earned income tax credit aimed at making work pay for the low-skilled.

(ii) Overall, the measures of the action plan, as presented in the addendum to the stability programme are generally in line with the general principles of the Commission Communication of 26 November 2008 on the European Economic Recovery Plan. First of all, the most important measures, like the easing of the depreciating rules for investment, the tax cuts for SME's and the working hours reduction are temporary measures, as they have all been given a clear end date. Furthermore, the measures are timely, as their impact will be focused on 2009 and 2010. Finally, they are targeted towards the source of the economic challenges. The first support package mainly targeted domestic demand, by stimulating investment, and addressing the increasing unemployment, through the reduction in working hours. The second support package presented in January, mainly targets the declining credit supply. The update of the stability programme also includes a series of structural measures, which are part of the longer-term policy reform agenda, and are therefore not presented as a response to the worsening of economic conditions but help in any case to address the current challenges posed by the downturn. The lowering of social contributions aims at boosting demand, while increasing labour supply at the same time. Furthermore, in order to reduce labour shedding and to ease the transition in the labour market, mobility centres are set up, which are based on public-private partnerships. The measures are related to the medium-term reform agenda and the country-specific recommendation proposed by the Commission on 28 January 2009 under the Lisbon Strategy for Growth and Jobs.

(iii) The Dutch MTO stands at -0.5% to -1.0% of GDP and has been achieved by the Netherlands in 2005 and respected thereafter. For 2008, according to the Commission services' interim forecast, the fiscal stance is restrictive, as the structural balance is expected to improve from -0.8% of GDP in 2007 to a balanced position in 2008. For 2009, as mentioned earlier, the interim forecast projects a deterioration of the structural balance to -1.0% of GDP, still respecting the MTO, but coinciding with its lower limit. For 2010, the structural balance is expected to deteriorate further, implying that the MTO would not be met. Based on the Commission services' projections, a return to the MTO in 2011 is not likely without policy change. The nominal budget is projected to record an even faster decline, from a surplus of about 1% to a deficit of 1½% in 2009 and 2¾% in 2010. Although these figures, if materialised, still represent a limited safety margin towards the 3% of GDP threshold, budgetary outcomes are still subject to considerable downside risks and the margins may not prove to be sufficient, especially concerning 2010. Gross public debt has increased sharply following the government operations to stabilise the financial markets, though the debt-to-GDP ratio is not expected to reach the 60% threshold, as it is projected to have peaked in 2008 at slightly over 57% of GDP. There are however significant upward risks to the debt ratio in the coming years, mainly stemming from the substantial guarantees granted by the government to the financial sector.

ANNEX 1. SPECIAL TOPIC: EFFICIENCY OF BUDGETARY RULES

1. INTRODUCTION

The Netherlands has been quite successful in conducting budgetary policy. This is evidenced by the fact that since 1994 the average budget deficit was 1.1% of GDP[15], outperforming the euro area deficit average of 2.3% of GDP. Furthermore, the budgetary target as set out in respective budget memorandums was only missed in three years. Finally, during the same period the public debt ratio was reduced by more than 30 pp to around 45% at the end of 2007.[16] This is linked to the budgetary framework in place in the Netherlands, which is better known as the trend-based fiscal framework.

Budgetary rules are needed to enhance the management of public finances. Their benefits largely depend on the efficiency of the rules themselves. This chapter will look at how efficient these rules have been in the Netherlands, taking into account that 2009 marks the fifteenth year since the framework was adopted.

Specifically, developed in the early 1990's, the budgetary rule was first introduced in 1994. It substituted the previous budgetary framework of deficit targeting and intended inter alia to tackle the problem of continuously reopening budgetary negotiations, as every change in public finances, regardless whether it came from the revenue or the expenditure side, required new budgetary discussions.

The trend-based fiscal framework incorporated lessons learned from earlier frameworks.[17] In particular, from the anti-cyclical fiscal policy conducted during the 1950's, which aimed at smoothing the economic cycle, it was learnt that timing, size and possible impact of measures on the economic cycle are hard to determine. The structural budget policy during the 1960's and 1970's, demonstrated, among other things, that it is not prudent to be overly optimistic in forecasting economic growth.

The main characteristics of the trend based fiscal framework are: (i) the use of real expenditure ceilings, which are determined once for the entire government period; (ii) automatic stabilisation on the revenue side; and (iii) the use of independent macro-economic assumptions.

Over the years the framework has gradually evolved. Successive governments have made changes in the framework, based on practical experiences and changing challenges. Interestingly, the focus of the framework has shifted from the (short-term) budget deficit to the (long term) fiscal sustainability. The framework will of course face new challenges. In the short term, the financial crisis will require the fiscal rule to ensure enough flexibility in order to support the economy, e.g. by letting the automatic stabilisers work freely, while ensuring long-term sustainability by maintaining the need for budgetary consolidation in the medium term. In the coming years it is likely that the framework will be severely tested, as in line with

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[15] Corrected for a one-off transaction involving housing corporations of 4.9% of GDP in 1995.

[16] Before it increased sharply to 57% in 2008, due to the government operations to stabilise the financial markets.

[17] See also Bos, F., "the Dutch fiscal framework; history, current practice and the role of the CPB", *CPB document 150*, Netherlands Bureau for Economic Policy Analysis, The Hague, July 2007.

the expected economic downturn, the government balance is projected to decrease sharply, approaching the 3% limit in 2010 according the Commission services' January 2009 interim forecast.

The goals of the trend based fiscal policy framework have roughly remained unchanged over time. This chapter will focus on the one key objective, i.e. to avoid pro-cyclicality.

It is organised as follows: section 2.2 gives an overview and the experiences of the framework, section 2.3 discusses the interaction of fiscal policy with the economic cycle, section 2.4 discusses in more detail the possible cyclicality of real expenditure ceilings and, finally, section 2.4 will present the conclusions with some policy recommendations.

2. TREND BASED FISCAL POLICY FRAMEWORK[18]

2.1. Overview

To end the problems with the deficit targeting approach, the Study Group on the Budget Margin[19] proposed the trend based fiscal framework in 1993, which was adopted by the government and implemented in 1994. The framework has a four-year horizon. After elections, when a new coalition government is formed, the partners set medium-term budgetary targets. These targets are not enshrined in law, but are embedded in a coalition agreement and are based on the needed fiscal adjustment during the government period. This adjustment depends on the fiscal challenges with regard to ageing and the requirements of the Stability and Growth Pact. The underlying macro economic scenario is provided for by the National Bureau for Economic Policy Analysis (CPB)[20], which ensures the objectivity of the projections.

The level of spending, related to the budgetary targets of the coalition agreement, is then captured in an expenditure ceiling, one of the key elements of the trend-based fiscal framework. The ceiling is divided into three sub categories: the 'core' central government sector, the social security sector and the healthcare sector. The ceiling is defined in net terms, i.e. gross expenditures minus certain non-tax revenues. Savings in one category may only be used to finance additional spending in the other categories in exceptional circumstances.

The expenditure ceilings are first set in nominal terms, at the start of the government period, for each year of the government's four-year tenure. In a second step, they are converted into real ceilings by using four-year inflation projections. As actual expenditure is by definition presented in nominal terms, the ceilings must be translated every year into nominal ceilings using the latest forecast for the domestic demand deflator.[21] In spring, when the budget for the

[18] This section is largely based on the IMF (2005) country report 05/225 and the European Commission (2007) Public Finances in EMU 2007.

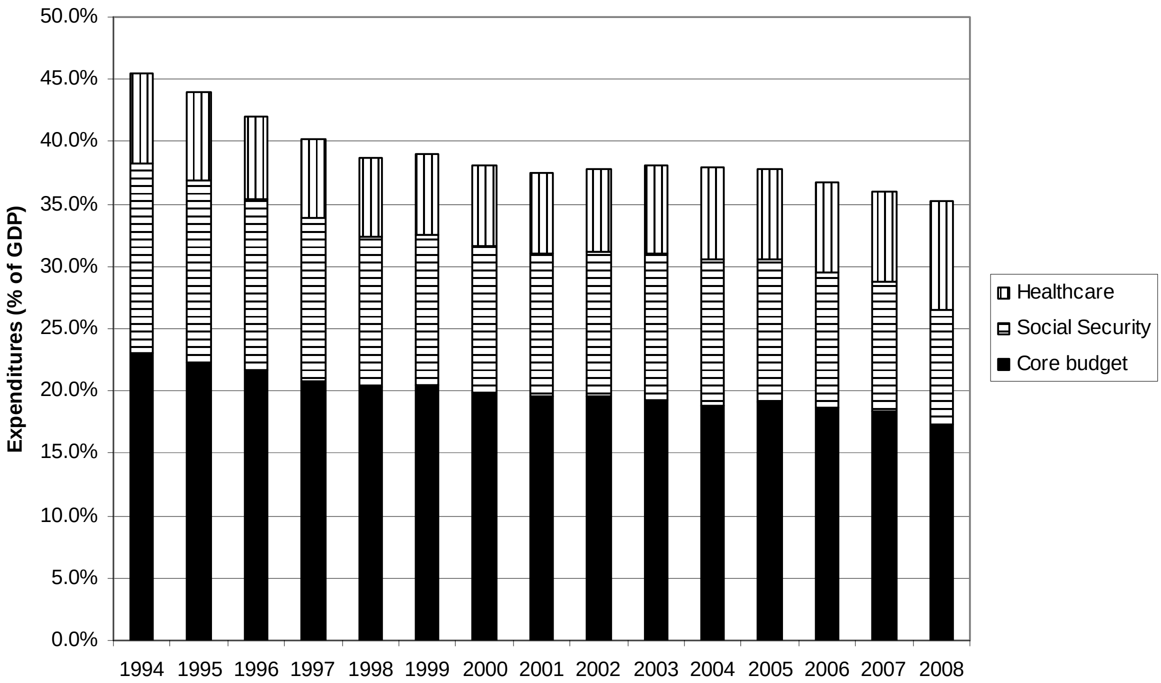
[19] The Study Group on the Budget Margin is a long-standing advisory council of high-level officials, including among others representatives of various ministries, the director of the CPB and an executive director of the central bank. It conducts periodic reviews of the functioning of the fiscal framework.

[20] The National Bureau for Economic Policy Analysis is better known as Centraal Planbureau (CPB) and is an independent governmental forecasting institution.

[21] Up until 2002 the GDP deflator was used.

current year is updated, the deflator forecast is reviewed and the ceiling is adjusted accordingly. After this review, the ceiling for the current year remains fixed in nominal terms.

Figure 1: Expenditure ceilings 1994 - 2008 (% of GDP)



The coverage of the expenditure ceiling is wide, but not exhaustive. The four main excluded items are expenditures from the Fund for Economic Structure enhancement (FES), interest payments, spending of local governments and tax expenditures. The FES is mainly funded with natural gas revenues. It has been separated from the budget process in order to safeguard a sufficiently high level of (infrastructure) investments. While there may be advantages to this arrangement from a political economy perspective, this earmarking has the disadvantage of separating the infrastructure investments from the choices faced in the general budgetary process and of reducing the reach of the expenditure ceilings.

Local government spending is subject to the requirement of balanced budgets in the medium term. In the short term, however, problems can arise for the general government balance as local government deficits can occur. This happened for example in 2003, when an unexpected deficit of 0.6% of GDP led to the breach of the 3% of GDP deficit threshold.

Since 2007, interest payments are excluded from the ceiling. Up until then, interest expenditures had been included. The main reason for excluding them was that unexpected changes in the interest payments had a direct effect on the primary expenditure under the ceiling, which is a fixed amount. In other words, since their exclusion, deviations from the expected interest payments do not affect primary expenditure, but have a direct impact on the government balance.

Tax expenditures are exempt from the expenditure ceilings. They are treated as an integral part of the tax revenues. At an estimated € 66.8 billon (over 11% of GDP), tax expenditures constitute an important form of government intervention. Although tax expenditures are periodically reviewed by the relevant ministries, some of the larger tax expenditures, such as the deductibility of mortgage interest payments, are exempt from this exercise. It could therefore be considered to make the tax expenditures subject to the expenditure ceilings.

Interestingly, unemployment spending is included under the ceilings, which could hamper the automatic stabilisation characteristic of unemployment benefits, as higher (lower) unemployment benefits will lead to lower (higher) other expenditure. According to the Study Group on the Budget Margin, however, this possible implication of including the unemployment benefits under the ceiling will largely be undone by the reverse effect of the business cycle on public sector wages and prices.[22]

The expenditure ceilings are strictly separated from revenues[23]. Changes in revenues cannot lead to changes in spending or vice versa. Furthermore changes in revenues will not be compensated through adjustments in tax rates, thus allowing the revenues to act fully as automatic stabilizers. [24] In line with for the expenditure ceiling, discretionary changes in taxes are determined for the entire government term. When adhered to this agreement, taxes and social contributions will only depend on non-policy factors.

In practice, the expenditure ceiling is well respected. The success is linked to the fixed nature of the framework, which turns the attention away from total expenditure and gives incentives to line-ministries to look for expenditure reallocations to finance new policy measures. It also reflects the fact that economic forecasts used to calculate the ceilings are based on projections from an independent institution.[25] The framework also contains a signal value for the government deficit: when the deficit approaches 2% of GDP, measures to increase revenues or cut expenditure should be taken.[26]

2.2. Experiences

When the trend-based fiscal framework was introduced, the government started to improve consistently from a deficit of 4.3%[27] of GDP in 1995 to a surplus of 2.0% of GDP in 2000. At the same time, the public debt diminished by more than 20 pp, while public expenditure was curtailed from over 53% to 46%, although it has to be acknowledged that this period coincided with an economic boom during which average GDP growth attained a rate of almost 4% per year. Furthermore, it coincided with the preparation for the Monetary Union.

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22 Studiegroep Begrotingsruimte (2006) vergrijzing en houdbaarheid, page 39.

23 Revenues consist of central government tax revenues, social contributions and non-tax gas revenues (+/- 41% of GDP) and are excluding other non-tax revenues (+/- 3% of GDP), which are accounted for under the expenditure ceiling.

24 During the period 1998-2002 the automatic stabilisers were somewhat mitigated, as part of windfalls or setbacks could be used for tax decreases or increases respectively.

25 Where up until 2007 a cautious scenario was used, this has been changed in the use of a realistic scenario, thereby lowering the chance of budgetary windfalls.

26 A new budgetary rule as presented in the November update of the stability programme, states that in case the 2% signal value is reached as a direct result from government operations to stabilise the financial markets, there will have to be no immediate action taken.

27 Corrected for a one-off transaction involving housing corporations of 4.9% of GDP in 1995.

In line with the economic slowdown, which started in 2001, fiscal developments turned less favourable, culminating in a deficit of 3.1% in 2003. The deterioration during this period was mainly due to three factors. First of all, despite the use of cautious macro-economic assumptions, the actual outcome was (much) worse than foreseen. For example, when setting the ceiling for 2003 in summer of 2002, GDP growth of 2.5% was expected for 2003. However, it turned out to be just 0.1%. Furthermore, there was a drop in revenues of about 2% of GDP between 2000 and 2003. This was partly caused by a large tax reduction in 2001, which accompanied the previously adopted tax reform. Finally, local governments unexpectedly ran a deficit of 0.6% in 2003, after having run close-to-balance for many years. This unexpected overrun contributed negatively to the general government balance breaching the 3% of GDP deficit limit, which triggered an excessive deficit procedure under the Stability and Growth Pact.

As a reaction to the excessive deficit, immediate action was taken to correct it. This led to fiscal tightening in 2004 and 2005. Since 2006, the budget is again in surplus, benefitting from high economic growth and rising natural gas revenues. However, the current financial crisis and its impact on the real economy pose new challenges to the trend based budgetary framework.

3. INTERACTION WITH THE ECONOMIC CYCLE

One of the main goals of the trend-based fiscal framework is to prevent pro-cyclicality of the government budget. This section will discuss the cyclical behaviour of the government balance. Furthermore, it will discuss whether the expenditure ceilings act independently from the cycle, as can be broadly expected.

3.1. Government balance

The cyclical behaviour of the framework can be assessed by observing the development of the government balance with respect to a measure reflecting the position in the business cycle.[28,29] Figure 1 shows the year-on-year change in fiscal stance relative to the output gap. It captures whether fiscal policy on average contributes to reducing or expanding existing cyclical imbalances (is pro-cyclical or counter-cyclical).

There are four possible situations: the output gap can be positive or negative and the fiscal stance can be loosening or tightening. In case of a tightening fiscal stance at the time of a positive output gap, fiscal policy has a diminishing effect on economic imbalances and thus behaves counter-cyclically (top-right quadrant). This will also be the case with the combination of a loosening fiscal stance and a negative output gap (bottom-left quadrant). Economic imbalances will be increased, indicating pro-cyclicality, when the fiscal stance is tightened while the output gap is negative indicating pro-cyclicality (top-left quadrant). This is also the case when a loosening fiscal stance is combined with a positive output gap (bottom-right quadrant).

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28 See also European Commission, macro fiscal assessment 2006 and 2007.

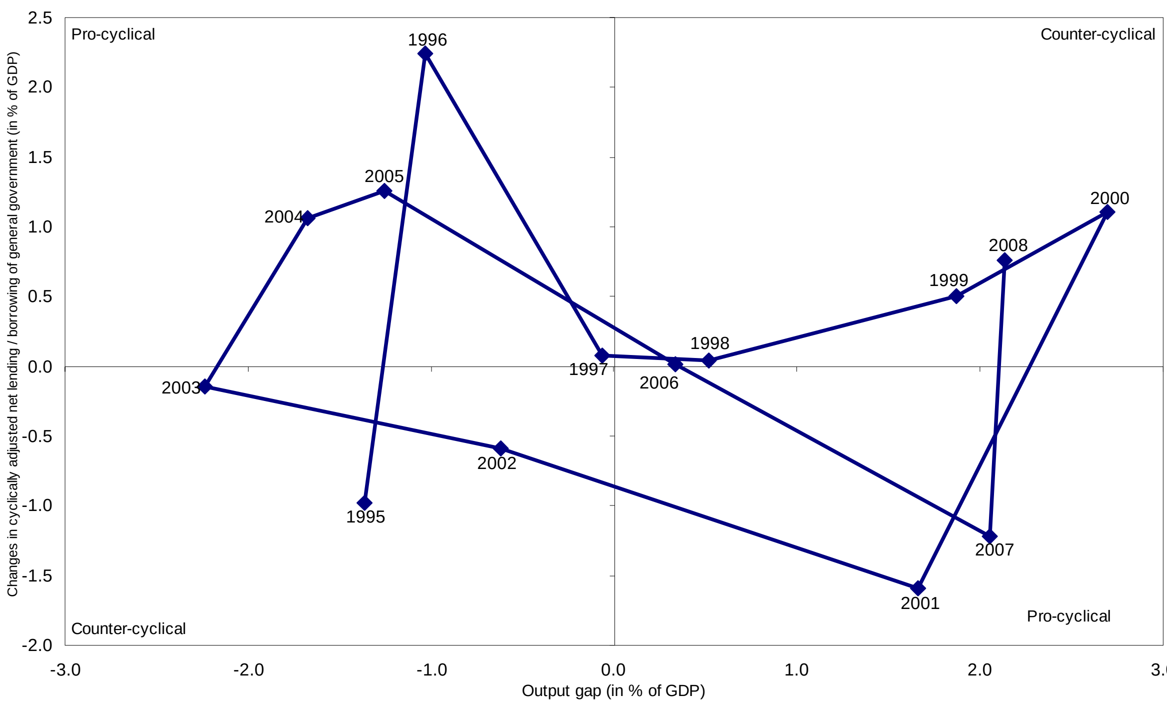
29 To this end the cyclically adjusted balance is used.

At first sight, figure 2 gives a mixed picture with the outcome evenly distributed over the four quadrants. The trend based fiscal policy framework does not seem to have a consistent positive or negative effect on the output gap. The level of impact on the business cycle, however, differs significantly. The average impact on the cycle of counter-cyclical years was ½ % of GDP, whereas the average impact of pro-cyclical years amounted to 1 ¼ % of GDP. Overall, this would point to a mildly pro-cyclical fiscal stance.

A closer look at the figure reveals three noteworthy observations. First of all, the year 2000 clearly shows the end of a long economic upswing. From 1995 onwards, the output gap has been consistently increasing. The fiscal stance in 2000 is, however, somewhat distorted by the UMTS auction, which amounted to 0.7% of GDP.

Second, in 2001 the economy was already slowing down but was still performing above potential. At that time it was decided that the tax reform, which was accompanied by a tax relief of 0.7% of GDP, would go ahead as planned, which made the pro-cyclical fiscal stance in that year more pronounced.

Figure 2: Changes in fiscal stance vs. output gap

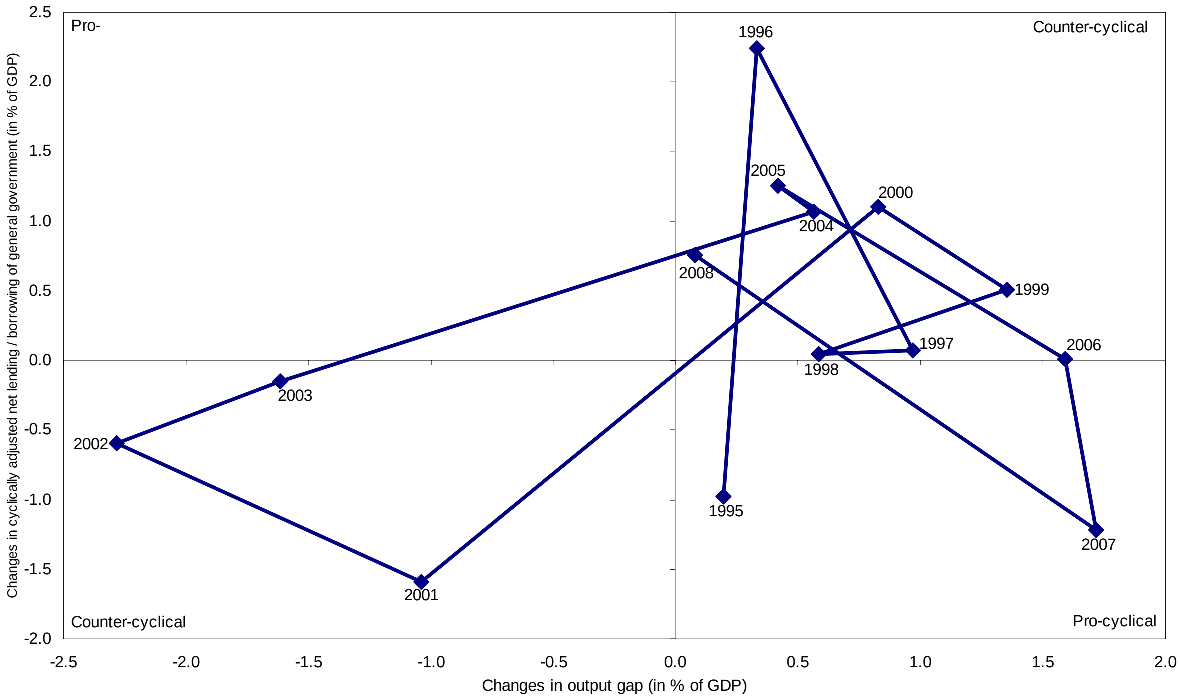


<u>Source</u>: CPB, Commission services

Third, after breaching the 3% threshold in 2003 some discretionary measures were taken in 2004 and 2005, leading to pro-cyclical behaviour of the budget (a tightening of fiscal policy in bad times). Excluding these two years, the framework seems to display a certain counter-cyclical behaviour.

Another way to assess the cyclicality of the budget policy framework is by looking at the change in fiscal stance relative to a *change* in the output gap, as is shown in figure 3. This is the concept of fiscal policy's counter-cyclicality at the margin.[30] It captures the reaction of the fiscal stance to cyclical movements. However, this has to be interpreted with caution in a situation where the output gap is negative but closing, e.g. in 2004 and 2005. A tightening fiscal stance would then be interpreted as being counter-cyclical, as the economic growth is returning to potential. At the same time, however, tightening fiscal policy increases the output gap, i.e. hampers economic growth to return to potential.

Figure 3: Changes in fiscal stance vs. changes in output gap



<u>Source</u>: CPB, Commission services

Figure 3 shows the same four quadrants as figure 2. The top two show a tightening fiscal stance, the lower two show a loosening fiscal stance. Both are combined with a widening output gap on the left side and an improving output gap on the right side. This figure shows a much clearer picture. The fiscal stance has been reacting predominantly counter-cyclically. Most of the years in which the impact on the cycle was pro-cyclical (1996, 2001, 2004 and 2006), the reaction to changes in the cycle were counter-cyclical. This would imply that the Dutch budget reacts swiftly to changes in the business cycle, which can ultimately result in a pro-cyclical fiscal stance.

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30 Turrini (2008), Fiscal policy and the cycle in the Euro Area: the role of government revenue and expenditure, European Commission and CEPR.

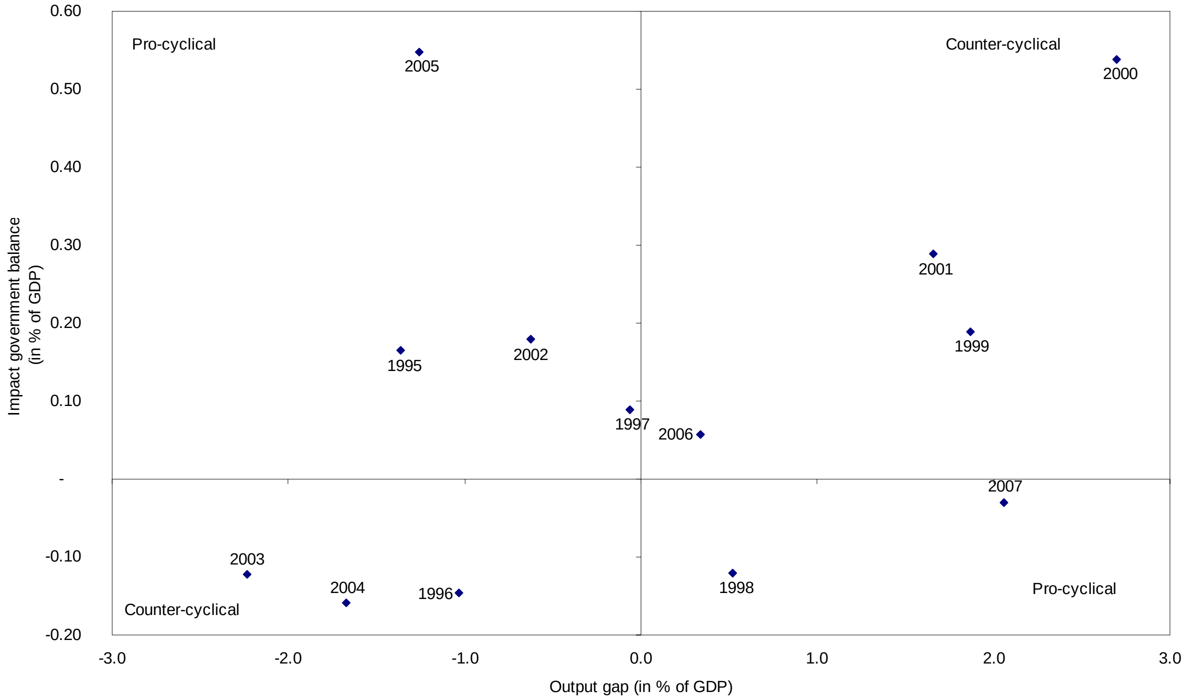
3.2. Expenditure ceilings

Every year the real ceiling, which had been established at the start of the government term, is translated into an operational nominal ceiling. Therefore, there is a case for analysing how real expenditure ceilings are converted into nominal ceilings and whether this has an impact on the counter-cyclical behaviour of fiscal policy.

Specifically, between 1994 and 2001, the GDP deflator was used to convert the real expenditure ceilings into nominal ones. However, since 2002, the domestic demand deflator has substituted the GDP deflator, as it was perceived to be less volatile. Changes in the domestic demand deflator relative to the changes in the GDP deflator can modify the expenditure-GDP ratio, and, as a result, alter the government balance.[31] These changes can become more pronounced as nominal ceilings are fixed in spring of a running year using the projected domestic demand deflator for that year.

In order to be able to assess current practice, the following calculations are based on what would have been the impact if the domestic demand deflator would have been used from the outset, given that our target is to analyse whether the framework is helping to fulfil the counter-cyclical goal of fiscal policy.

Figure 4: Impact on government balance resulting from deflator vs. output gap



<u>Source</u>: CPB, Commission services

[31] It is assumed that the expenditures always equal the ceilings, i.e. there are no overruns and there is no room under the ceiling.

Figure 4 depicts the change in the government balance budget deficit resulting from differences between the (projected) domestic demand deflator and the GDP deflator on the y-axis. A positive (negative) outcome means that the GDP deflator was higher (lower) than the domestic demand deflator used for the expenditure ceiling, which corresponds to fiscal tightening (loosening). The x-axis shows the output gap. Cyclicality would require a linear relationship, with either an upward or downward slope, representing respectively counter- and pro-cyclical behaviour. As can be seen in the figure, the system used to convert the real ceilings into nominal ones, tends to be independent from the economic cycle.

Although the system used does not lead to pro-cyclicality, it does have an impact on the government balance. Figure 3 shows that the impact on the government balance of differences between the (projected) domestic demand deflator and the GDP deflator can indeed be substantial, although not for every year. Specifically, the largest effect was recorded at 0.55% of GDP in 2005 and was deficit improving. There also seems to be an average bias towards a positive impact on the budget balance of 0.11% of GDP since 1995. This seems to be caused by the fact that the GDP and the domestic demand deflator are somewhat underestimated in spring. Furthermore, the domestic demand deflator has been on average somewhat lower than the GDP deflator.

4. CONCLUSION

The introduction of the trend based fiscal framework in the Netherlands in 1994 seems to have been quite successful. The average budget deficit has been one of the lowest within the euro area and the public debt ratio has been diminished by about 30 pp until 2007[32].

In order to further assess the success of the framework, one has to look at the efficiency of the budgetary rules. In this chapter this was done by focusing one key objective: avoiding pro-cyclicality.

When looking at the interaction with the business cycle, it seems that fiscal policy reacts counter-cyclically to changes in the business cycle. The impact of this reaction on the business cycle itself, though, is more ambiguous.

Furthermore, it can be concluded that the method used to convert the real expenditure ceilings into nominal ceilings does not lead to pronounced cyclical behaviour on the expenditure side although it tends to reduce the deficit. This impact is partly explained by the fact that for the conversion of real ceilings into nominal ones, the domestic demand deflator is used instead of the GDP deflator, which is thought to be too volatile, as it would interfere with the budgetary decision making process.

Over the years, the framework has been evolving according to practical experiences and changing challenges. While most changes constituted improvements, like the introduction of the signal value[33] for the government balance to avoid breaching the 3% of GDP threshold and the exclusion of interest payments from the ceiling, some further changes might be considered. For example, the treatment of FES expenditures could be changed in the framework, so as to further increase the control over total government expenditure.

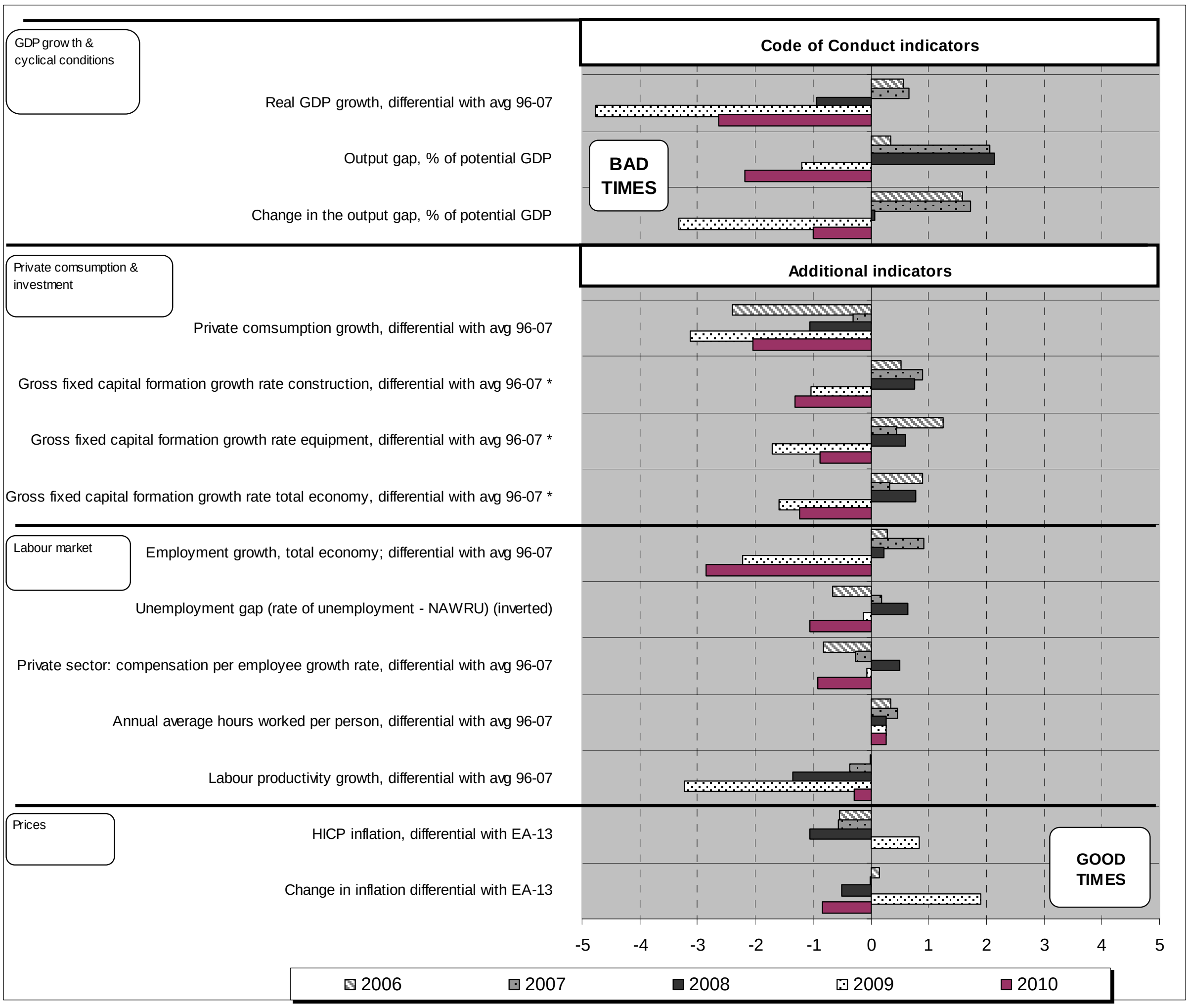
[32] In 2008 the debt ratio increased by approximately 15% of GDP despite a budget surplus of 1.1% of GDP, due to the government operations to stabilise the financial markets.

[33] As stated in paragraph 2.1, the signal value is not fully applied at this moment, when a breach of this signal value is a consequence of the government operations to stabilise the financial markets.

Furthermore, changes with a view to improving the sustainability of public finances could be thought of, such as reviewing the use of natural gas revenues in the budgetary process.

ANNEX 2. ADDITIONAL TABLES AND FIGURES

Figure 1: Good and bad economic times



<u>Source</u>: Commission services' January 2009 forecast (COM) and successive stability programmes

Table 1: Budgetary implementation in 2008

	2007		2008	
	Planned SP Nov 2007	**Outcome** COM	**Planned** SP Nov 2007	**Outcome** COM
Government balance (% of GDP)	-0.4	0.3	0.5	1.1
Difference compared to target	**0.7**		**0.6**	
Of which : due to a different starting position end 2007			0.7	
due to different revenue / expenditure growth in 2008			-0.1	
p.m. Denominator effect and residual [2,3]			0.0	
p.m. Nominal GDP growth (planned and outcome)			4.5	4.4
Revenue (% of GDP)	45.9	45.6	46.9	46.8
Revenue surprise compared to target [1]	**-0.3**		**-0.1**	
Of which : due to a different starting position end 2007			-0.3	
due to different revenue growth in 2008			0.1	
p.m. Denominator effect [2]			0.0	
p.m. Residual [3]			0.0	
p.m. Revenue growth rate (planned and outcome)			6.8	7.1
Expenditure (% of GDP)	46.3	45.3	46.4	45.7
Expenditure surprise compared to target [1]	**1.0**		**0.7**	
Of which : due to different starting position end 2007			1.0	
due to different expenditure growth rate in 2008			-0.2	
p.m. Denominator effect [2]			0.0	
p.m. Residual [3]			0.0	
p.m. Expenditure growth rate (planned and outcome)			4.7	5.2

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source : Commission services

Table 2: Evolution of budgetary targets in successive programmes

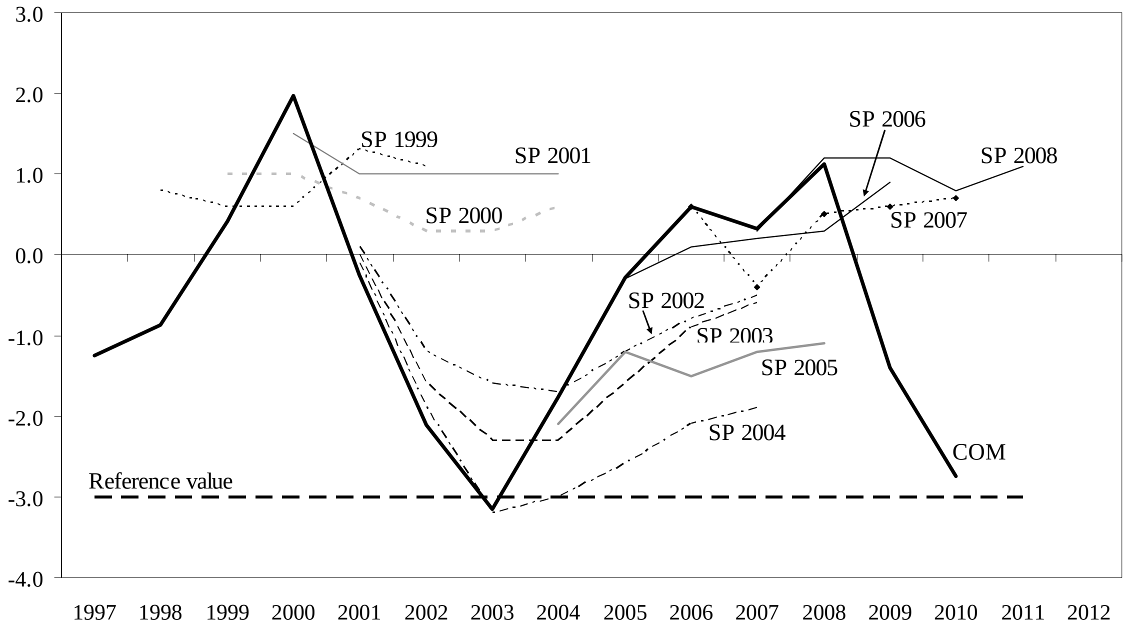
		2007	2008	2009	2010	2011
General government balance (% of GDP)	**SP Dec 2008**	**0.3**	**1.2**	**1.2**	**0.8**	**1.1**
	SP Nov 2007	*-0.4*	*0.5*	*0.6*	*0.7*	*n.a.*
	COM Jan 2009	0.3	1.1	-1.4	-2.7	n.a.
General government expenditure (% of GDP)	**SP Dec 2008**	**45.3**	**45.4**	**45.1**	**45.3**	**45.2**
	SP Nov 2007	*46.3*	*46.4*	*46.3*	*46.5*	*n.a.*
	COM Jan 2009	45.3	45.7	47.4	48.3	n.a.
General government revenue (% of GDP)	**SP Dec 2008**	**45.6**	**46.6**	**46.3**	**46.1**	**46.3**
	SP Nov 2007	*45.9*	*46.9*	*46.9*	*47.2*	*n.a.*
	COM Jan 2009	45.6	46.8	46.1	45.6	n.a.
Structural balance[1] (% of GDP)	**SP Dec 2008**	**-0.1**	**0.8**	**1.0**	**1.1**	**1.5**
	SP Nov 2007	*-0.2*	*0.5*	*0.7*	*n.a.*	*n.a.*
	COM Jan 2009	-0.8	0.0	-1.0	-1.5	n.a.
Real GDP (% change)	**SP Dec 2008**	**3.5**	**2¼**	**1¼**	**2**	**2**
	SP Nov 2007	*2¾*	*2½*	*1¾*	*1¾*	*n.a.*
	COM Jan 2009	3.5	1.9	-2.0	0.2	n.a.

Note:

[1]Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes. One-off and other temporary measures are0.3% of GDP in 2009; all deficit-reducing, according to the most recent programme and the Commission services' January interim forecast.

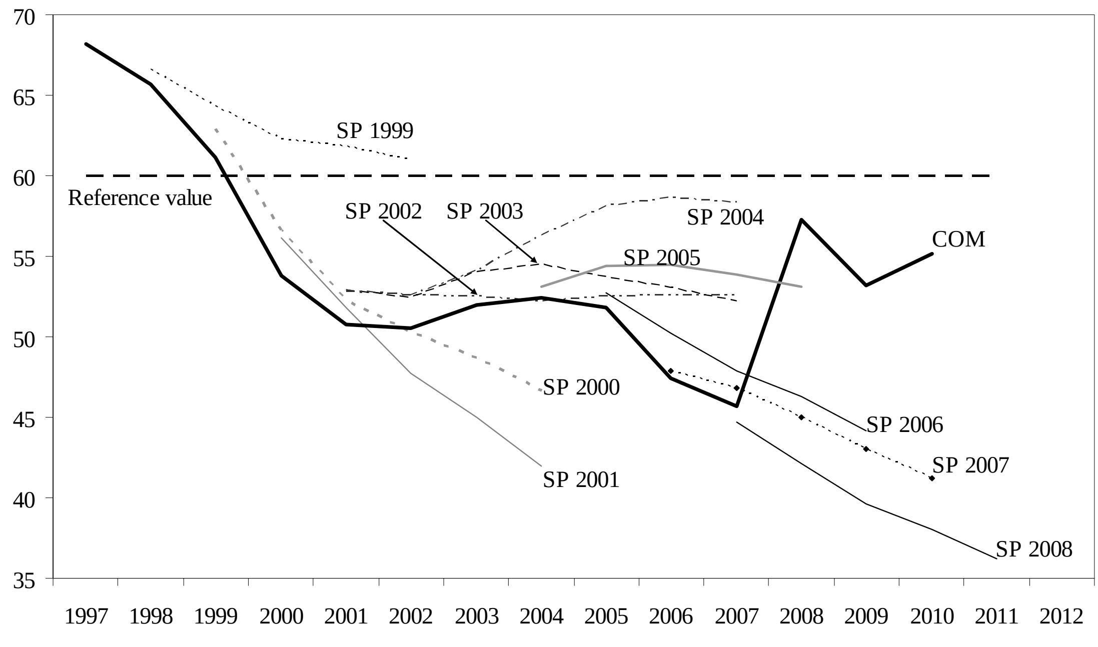
Source :
Stability programmes (SP); Commission services' January 2009 interim forecasts (COM)

Figure 2: Government balance projections in successive programmes (% of GDP)



<u>Source</u>: Commission services' January 2009 interim forecast (COM) and successive stability programmes

Figure 3: Debt projections in successive programmes (% of GDP)



<u>Source</u>: Commission services' January 2009 interim forecast (COM) and successive stability programmes

Table 3: Long-term age-related expenditure: main projections

(% of GDP)	2004	2010	2020	2030	2040	2050	Change 2010- 50
Total age-related spending	**20.9**	**20.6**	**22.4**	**24.7**	**26.2**	**25.8**	**5.2**
- Pensions	7.7	7.6	9.0	10.7	11.7	11.2	3.6
- Healthcare	6.1	6.3	6.7	7.1	7.4	7.4	1.1
- Long-term care	0.5	0.5	0.5	0.8	0.9	1.1	0.6
- Education	4.8	4.7	4.6	4.6	4.7	4.6	-0.1
- Unemployment benefits	1.8	1.5	1.5	1.5	1.5	1.5	0.0
Property income received	**2.3**	**2.1**	**1.9**	**1.7**	**1.4**	**1.2**	**-0.9**

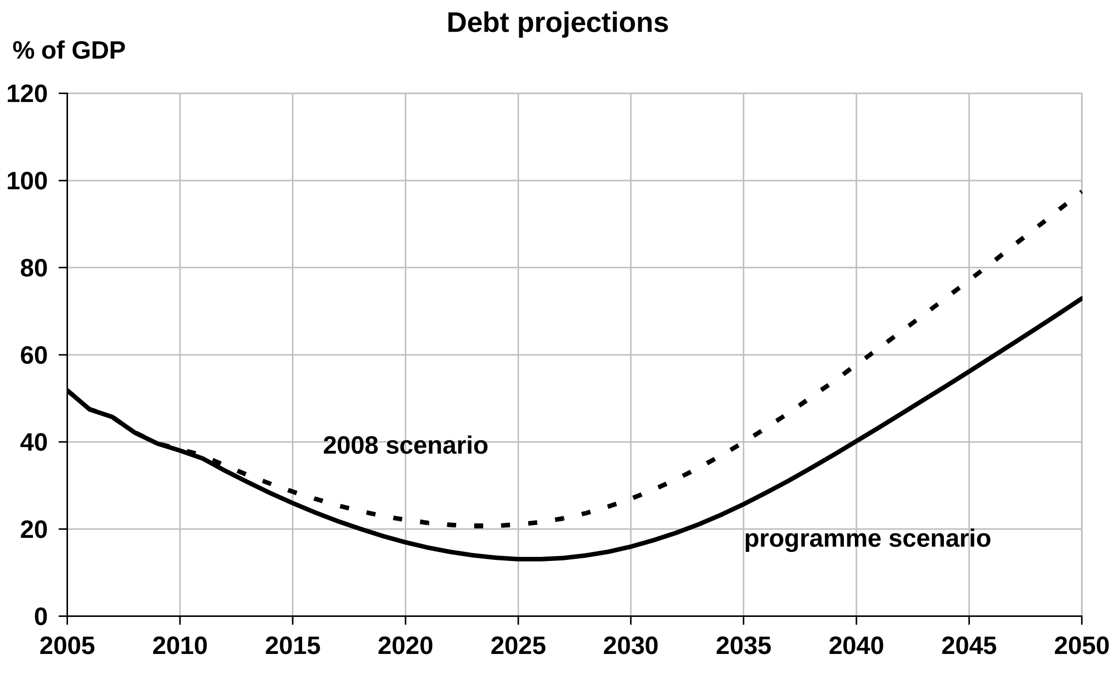
Source: Economic Policy Committee and Commission services.

Table 4: Sustainability indicators and the required primary balance

	2008 scenario			Programme scenario		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	0.7	2.6	4.9	0.3	2.1	4.9
of which:						
Initial budgetary position (IBP)	-2.1	-1.8	-	-2.6	-2.3	-
Debt requirement in 2050 (DR)	-0.5	-	-	-0.5	-	-
Long-term change in the primary balance (LTC)	3.3	4.4	-	3.3	4.4	-

Source: Commission services.

Figure 4: Long-term projections for the government debt ratio



Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.
Source: Commission services

Table 5: Additional factors

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2010 in COM January forecast 2009	-
Significant revenues from pension taxation	+
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	na
Non-age related budgetary measures with intertemporal effect	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability. 'na': not applicable.
Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".
An explanation on these factors can be found in chapter IV of: European Commission (2006), The long-term sustainability of public finances in the European Union, European Economy No. 4/2006.
Source: Commission services.

ANNEX 3. COMPLIANCE WITH THE CODE OF CONDUCT AND TABLES FROM THE PROGRAMME

The programme broadly follows the model structure and date provision requirements for stability and convergence programmes specified in the new code of conduct.

All compulsory data specified in the standard tables in Annex 2 of the code of conduct, as amended by the September 2007 EFC, have been supplied. Most optional data suggested by the new code of conduct is also available (table 2).

The tables on the following pages show the data presented in the November 2008 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

Table 1a. Macroeconomic prospects

	ESA Code	2007 Level	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change
1. Real GDP	B1*g	*567.1*	3.5	2¼	1¼	2	2
2. Nominal GDP	B1*g	*567.1*	5	4¼	4½	3¾	3¾
Components of real GDP							
3. Private consumption expenditure	P.3	*264.3*	2.1	1½	1	1¼	1¼
4. Government consumption expenditure	P.3	*142.5*	3.0	1¼	2	1½	1½
5. Gross fixed capital formation	P.51	*113.2*	4.9	4½	-1	2	2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*-1.6*	-0.2	0.0	0.2	0	0
7. Exports of goods and services	P.6	*424.8*	6½	3¾	2¾	5¾	5¾
8. Imports of goods and services	P.7	*376.1*	5.7	3¾	2½	5½	5½
Contributions to real GDP growth							
9. Final domestic demand		*520.0*	2.7	1.9	0.8	1¼	1¼
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	*-1.6*	-0.2	0.1	0.0	0	0
11. External balance of goods and services	B.11	*48.7*	1	0.3	½	½	½

Table 1b. Price developments

	ESA Code	2007 Level	2007 rate of change	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change
1. GDP deflator		*100*	1.5	2¼	3½	1¾	1¾
2. Private consumption deflator		*100*	1.6	3	3¼	1¾	1¾
3. HICP[1]		*100*	1.6	2½	3¼	2	2
4. Public consumption deflator		*100*	2.1	2½	4½	3	3
5. Investment deflator		*100*	1.4	1¾	2½	1	1
6. Export price deflator (goods and services)		*100*	1.2	5¼	2½	-1	-1
7. Import price deflator (goods and services)		*100*	1.3	6	2¼	-1	-1

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons[1]		*8613*	2.5	2	½	½	½
2. Employment, hours worked[2]		*12.0*	2.3	1¾	¼	½	½
3. Unemployment rate (%)[3]		*4.5*	4.5	4	4¼	3	3
4. Labour productivity, persons[4]		*65.8*	1.0	¼	¾	1¼	1¼
5. Labour productivity, hours worked[5]		*9.8*	1.1	½	1	1½	1½
6. Compensation of employees	D.1	*279.7*	3.4	4¼	4	4¼	4¼
7. Compensation per employee		*47.3*	3.2	4¼	4	3½	3½

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2007	2008	2009	2010	2011
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	9.5	8.5	9.5	7.5	8.0
of which : - Balance on goods and services		8.6	8.4	8.8	7.5	7.8
- Balance of primary incomes and transfers		2.7	1.7	1.8	1.2	1.3
- Capital account		-1.5	-1.5	-1.0	-1.2	-1.2
2. Net lending/borrowing of the private sector	B.9	9.2	7.2	8.2	6.8	6.9
3. Net lending/borrowing of general government	EDP B.9	0.3	1.2	1.2	0.8	1.1
4. Statistical discrepancy		0.0	0.0	0.0	0.0	0.0

Table 2. General government budgetary prospects

	ESA Code	2007	2007	2008	2009	2010	2011
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	*1973*	0.3	1.2	1.2	0.8	1.1
2. Central government	S.1311	*3465*	0.6	1.2	1.5	0.8	0.8
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-40*	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	*-1452*	-0.3	0.0	-0.3	0.0	0.3
General government (S13)							
6. Total revenue	TR	*258772*	45.6	46.6	46.3	46.1	46.3
7. Total expenditure	TE[1]	*256918*	45.3	45.4	45.1	45.3	45.2
8. Net lending/borrowing	EDP B.9	*1973*	0.3	1.2	1.2	0.8	1.1
9. Interest expenditure	EDP D.41	*12525*	2.2	2.2	2.1	2.1	2.0
10. Primary balance[2]		*14498*	2.6	3.4	3.3	2.9	3.1
11. One-off and other temporary measures[3]		*0*	0.0	0.0	0.3	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		*141067*	24.9	25.6	25.6	25.5	25.2
12a. Taxes on production and imports	D.2	*71213*	12.6	12.7	12.7	12.7	12.6
12b. Current taxes on income, wealth, etc	D.5	*67974*	12.0	12.6	12.6	12.5	12.3
12c. Capital taxes	D.91	*1880*	0.3	0.3	0.3	0.3	0.3
13. Social contributions	D.61	*81107*	14.3	14.5	14.1	14.5	15.0
14. Property income	D.4	*12648*	2.2	2.6	2.5	2.3	2.2
15. Other[4]		*23950*	4.2	3.9	4.1	3.8	3.9
16=6. Total revenue	TR	*258772*	45.6	46.6	46.3	46.1	46.3
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			39.2	40.1	39.7	40.0	40.2
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	*92987*	16.4	16.4	16.5	16.5	16.5
17a. Compensation of employees	D.1	*51936*	9.2	9.2	9.3	9.3	9.3
17b. Intermediate consumption	P.2	*41051*	7.2	7.2	7.2	7.2	7.2
18. Social payments (18=18a+18b)		*113212*	20.0	20.0	19.6	19.8	19.8
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*54428*	9.6	9.6	9.4	9.5	9.5
18b. Social transfers other than in kind	D.62	*58784*	10.4	10.4	10.2	10.3	10.3
19=9. Interest expenditure	EDP D.41	*12525*	2.2	2.2	2.1	2.1	2.0
20. Subsidies	D.3	*7159*	1.3	1.3	1.3	1.3	1.3
21. Gross fixed capital formation	P.51	*18910*	3.3	3.4	3.5	3.5	3.5
22. Other[6]		*12125*	2.1	2.1	2.1	2.1	2.1
23=7. Total expenditure	TE[1]	*256918*	45.3	45.4	45.1	45.3	45.2
p.m.: Government consumption (nominal)	P.3	*142481*	25.1	24.9	25.1	25.4	25.7

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

[2] The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3] A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

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

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2007	2008	2011
1. General public services	1	7.3	7.3	7.0
2. Defence	2	1.4	1.4	1.4
3. Public order and safety	3	1.8	1.8	1.8
4. Economic affairs	4	4.7	4.7	4.7
5. Environmental protection	5	0.8	0.8	0.8
6. Housing and community amenities	6	1.0	0.9	0.9
7. Health	7	5.7	5.7	6.0
8. Recreation, culture and religion	8	1.4	1.3	1.3
9. Education	9	5.1	5.1	5.1
10. Social protection	10	16.4	16.3	16.2
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	45.6	45.3	45.2

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

Table 4. General government debt developments

% of GDP	ESA Code	2007	2008	2009	2010	2011
1. Gross debt[1]		45.7	42.1	39.6	38	36.2
2. Change in gross debt ratio		-1.7	-3.6	-2.5	-1.6	-1.8
Contributions to changes in gross debt						
3. Primary balance[2]		2.6	3.4	3.3	2.9	3.1
4. Interest expenditure[3]	EDP D.41	2.2	2.2	2.1	2.1	2.0
5. Stock-flow adjustment		2.5	1.4	1.3	0.8	0.7
of which: - Differences between cash and accruals[4]		0.2	0.2	0.2	0.0	0.1
- Net accumulation of financial assets[5]		1.1	-0.5	-0.1	0.1	-0.1
of which: *- privatisation proceeds*		0.0	0.0	0.0	0.0	0.0
- Valuation effects and other[6]		-2.2	-1.9	-1.9	-1.1	-1.0
p.m.: Implicit interest rate on debt[7]		4.1	4.1	4.1	4.1	4.1
Other relevant variables						
6. Liquid financial assets[8]		n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

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

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

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]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	2007	2008	2009	2010	2011
1. Real GDP growth (%)		3.5	2¼	1¼	2	2
2. Net lending of general government	EDP B.9	0.3	1.2	1.2	0.8	1.1
3. Interest expenditure	EDP D.41	2.2	2.2	2.1	2.1	2.0
4. One-off and other temporary measures[1]		0.0	0.0	0.3	0.0	0.0
5. Potential GDP growth (%)		2.3	2.4	2.2	2.1	2.0
contributions:		2.3	2.4	2.2	2.1	2.0
- labour		0.6	0.6	0.6	0.4	0.4
- capital		0.7	0.8	0.7	0.7	0.7
- total factor productivity		1.0	0.9	0.9	1.0	0.9
6. Output gap		0.65	0.6	-0.35	-0.45	-0.45
7. Cyclical budgetary component		-0.4	-0.3	-0.1	0.1	0.1
8. Cyclically-adjusted balance (2 - 7)		-0.1	0.9	1.1	0.9	1.2
9. Cyclically-adjusted primary balance (8 + 3)		2.1	3.1	3.2	3.0	3.2
10. Structural balance (8 - 4)		n.a.	n.a.	n.a.	n.a.	n.a.

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2007	2008	2009	2010	2011
Real GDP growth (%)						
Previous update		2.75	2.5	1.75	1.75	n.a.
Current update		3.5	2.25	1.25	1.75	1.75
Difference		0.75	-0.25	-0.5	0	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		-0.4	0.5	0.6	0.7	n.a.
Current update		0.3	1.2	1.2	0.8	1.1
Difference		0.7	0.7	0.6	0.1	n.a.
General government gross debt (% of GDP)						
Previous update		46.8	45.0	43.0	41.2	n.a.
Current update		45.7	42.1	39.6	38	36.2
Difference		-1.1	-2.9	-3.4	-3.2	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure[1]	n.a.	45.1	45.2	47.0	49.3	50.4
Of which: age-related expenditures	n.a.	20.5	20.6	22.4	24.7	25.8
Pension expenditure	n.a.	7.4	7.6	9.0	10.7	11.2
Social security pension	n.a.	1.7	1.5	1.5	1.5	1.5
Old-age and early pensions	n.a.	4.8	5.2	6.7	8.6	9.4
Other pensions (disability, survivors)	n.a.	2.6	2.4	2.3	2.1	1.9
Occupational pensions (if in general government)	n.a.	4.8	4.7	5.8	7.7	8.7
Health care	n.a.	6.1	6.3	6.7	7.1	7.4
Long-term care *(this was earlier included in the health care)*	n.a.	0.5	0.5	0.5	0.8	1.1
Education expenditure	n.a.	4.8	4.7	4.6	4.6	4.6
Other age-related expenditures	n.a.	0	0	0	0	0
Interest expenditure	n.a.	2.4	2.0	0.8	0.4	2.3
Total revenue	n.a.	45.9	45.7	45.6	45.3	44.8
Of which: property income	n.a.	2.3	1.9	1.4	1.4	0.7
Of which : from pensions contributions (or social contributions if appropriate)	n.a.	4.0	4.0	4.0	4.0	4.0
Pension reserve fund assets	n.a.	140.8	159.0	196.1	230.5	241.9
Of which : consolidated public pension fund assets (assets other than government liabilities)	n.a.	0	0	0	0	0
Assumptions						
Labour productivity growth	n.a.	0.8	1.7	1.7	1.7	1.7
Real GDP growth	n.a.	1.4	2.1	1.6	1.3	1.7
Participation rate males (aged 20-64)	n.a.	84.0	83.1	82.8	82.2	83.2
Participation rates females (aged 20-64)	n.a.	70.1	72.4	75.4	76.3	77.7
Total participation rates (aged 20-64)	n.a.	77.1	77.8	79.1	79.3	80.5
Unemployment rate	n.a.	3.5	3.2	3.2	3.2	3.2
Population aged 65+ over total population	n.a.	20.7	22.2	29.2	37.2	40.6

[1]These figures have not been published by the AWG. The method is derived from the sustainability report 2006: the non-age-related revenues and expenditures are kept constant at the 2005 level (taken from tabel a.3.5 of Public Finance Report 2007). Age-related revenues (property income, D4) and expenditures are then added to make up the grand total.

Table 8. Basic assumptions

	2007	2008	2009	2010	2011
Short-term interest rate (annual average)	4.3	5	4¾	4½	4½
Long-term interest rate (annual average)	4.3	4½	5	4½	4½
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.37	1.55	1.57	1.45	1.45
Nominal effective exchange rate	3.9	5¾	½	1	1
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
World GDP growth	4.9	3¾	3½	4¾	4¾
World excluding EU, GDP growth	5.4	4½	4	5¼	5¼
EU GDP growth	3.1	1¾	1½	2½	2½
Growth of relevant foreign markets[1]	6.3	3¼	3¾	6¼	6¼
World import volumes, excluding EU	9.9	6½	6¾	6½	6½
Oil prices (Brent, USD/barrel)	72½	118	125	68	65

Source: CPB document 151, figures for world GDP growth, EU GDP growth, and world GDP growth excluding EU are consistent with this document but not provided there; Oil prices for 2010 and 2011 are the ministry of Finance's own conservative estimates.

[1]Taken to be equivalent to the Dutch "relevant wereldhandelsvolume" (volume of relevant world trade).

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