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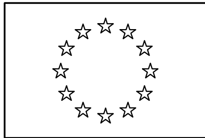

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.2.2009
SEC(2009) 169 final

Recommendation for a

COUNCIL OPINION

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

On the updated stability programme of the Netherlands, 2008-2011

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The 2005 reform of the Pact acknowledged its usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. In particular, it introduced greater flexibility in the application of the rules governing the excessive deficit procedure, notably with regard to definition of "exceptional circumstances" and the setting of deadlines for the correction of an excessive deficit.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Stability and Growth Pact, stipulates that each Member State has to submit, to the Council and the Commission, a stability or convergence programme and annual updates thereof. Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the stability programme of the Netherlands, submitted on 28 November 2008, and its addendum, submitted on 19 December, and has adopted a recommendation for a Council opinion on it.

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

(1) the Commission Communication of 26 November 2008 (“A European Economic Recovery Plan”), and

(2) the most recent assessment of the country’s position under the preventive arm of the Stability and Growth Pact (summary of the Council opinion on the previous update of the stability programme).

2.1. The Commission Communication of 26 November 2008 (“A European Economic Recovery Plan”)

In view of the unprecedented scale of the global financial and economic crisis, the European Commission has called for a European Economic Recovery Plan (EERP)[2]. The plan proposes a co-ordinated counter-cyclical macro-economic response to the crisis in the form of an ambitious set of actions to support the economy consisting of (i) an immediate budgetary impulse amounting to €200 bn. (1.5% of EU GDP), made up of a budgetary expansion by

[1] OJ L 209, 2.8.1997, p. 1. The documents referred to in this text are available at: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

[2] Communication from the Commission to the European Council of 26 November 2008 - COM(2008) 800.

Member States of € 170 bn. (around 1.2% of EU GDP) and EU funding in support of immediate actions of the order of €30 bn. (around 0.3 % of EU GDP); and (ii) a number of priority actions grounded in the Lisbon Strategy and designed to adapt our economies to long-term challenges, continuing to implement structural reforms aimed at raising potential growth. The plan calls for the fiscal stimulus to be differentiated across Member States in accordance with their positions in terms of sustainability of government finances and competitive positions. In particular, for Member States outside the euro area with significant external and internal imbalances, budgetary policy should essentially aim at correcting such imbalances. The plan was agreed by the European Council on 11 December 2008. In this context, Member States were asked to submit an addendum to their updated stability or convergence programme, so as to reflect the measures taken in the context of the Recovery Plan. The examination of how measures (budgetary measures as well as structural measures) contribute to the recovery process in the short term is made in the opinions of stability convergence programmes.

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

In its opinion of 12 February 2008, the Council summarised its assessment of the previous update of the stability programme, covering the period 2007-2010, as follows: “The overall conclusion is that the programme aims at achieving and maintaining a broadly stable surplus, thereby ensuring a sound budgetary position throughout the period. While fiscal policy was pro-cyclical in good economic times in 2007, the budgetary stance in the programme from 2008 onwards is in line with the Pact. The risks tot the budgetary targets seem broadly balanced in 2008. From 2009 onwards, if economic growth turns out better than the cautious economic scenario envisaged in the programme, this should be reflected in a better budgetary outcome than planned. As regards the long-term sustainability of public finances, the Netherlands appear to be at medium risk. "In view of this assessment and in light of the projected increase in age-related expenditure and the recent deterioration of the structural balance, the Council invited the Netherlands to" improve the long-term sustainability of public finances by securing the budgetary consolidation as planned in the programme.”

Recommendation for a

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

On the updated stability programme of the Netherlands, 2008-2011

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [10 March 2009] the Council examined the updated stability programme of the Netherlands, which covers the period 2008 to 2011.

(2) 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 a significant carry-over effect from strong domestic demand in the second half of 2007, resulting from high private consumption growth. In 2009, economic activity is expected to contract sharply by 2% according to the Commission services' January 2009 interim forecast. The very open Dutch economy will be relatively hard hit by the expected fall in world trade. The main policy challenges in the downturn are related to both the financial sector, by addressing the very low confidence and falling asset positions of pension funds, and to the real economy, by supporting investment and competitiveness. The downturn will have a significant impact on public finances, as a projected surplus in 2008 is expected to turn into a deficit in 2009, which will further increase in 2010. This also takes into account the impact of the support package as presented in November, which among others provides support for private investment.

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

(3) On 19 December 2008 the Netherlands submitted an addendum to the Stability programme, containing a recovery plan and a partial update of the macro-economic scenario. This addendum shows much less optimistic figures than the programme, with GDP growth of -¾% in 2009 and 1% in 2010 and the general government deficit at 1.2% and 2.4% of GDP. However, the new figures will not be used as the baseline for the assessment, as the macroeconomic scenario was not fully fledged and public finance data have been presented for information purposes rather than with official endorsement by the Ministry of Finance.

(4) The macroeconomic scenario underlying the programme envisages that real GDP will decelerate from 2¼% in 2008 to 1¼% in 2009 before recovering to an average rate of 2% over the rest of the programme period. In view of the rapid deterioration of the macro-economic outlook in the past months, this scenario, which was finalised in September[4], appears to be based on markedly favourable growth assumptions, when compared to the Commission services' January interim forecast. Even the GDP growth figure for 2009 as presented in the addendum (-¾%) is still favourable compared to the Commission services' forecast. Specifically, the most recent available information points to a sharp contraction of investment on the back of tighter credit conditions, as well as a rapid fall of exports given the weak external demand. Both the (limited) budgetary and economic impact of the support package is not reflected in the macroeconomic scenario. The programme's projections for inflation appear to be on the high side for 2009, but seem to be realistic for the period thereafter.

(5) For 2008, the general government balance is estimated at a surplus of 1.1% of GDP in the Commission services' January 2009 interim forecast, against a surplus target of 0.5% of GDP set in the previous update of the stability programme. The improvement is mainly due to a better-than-expected outcome in 2007. Furthermore, revenue growth in 2008 was somewhat higher than expected, as higher gas revenues were only partly compensated by lower tax revenues resulting from the financial crisis. Expenditure growth in 2008 was also slightly higher, largely reflecting higher-than-expected interest payments and child care expenditure.

(6) The budgetary target for 2009 in the update is a surplus of 1.2% of GDP, which compares with a projected deficit of 1.4% of GDP in the Commission services' interim forecast. The structural balance, according to the information provided in the update of the stability programme and recalculated by the Commission services, is projected to attain a surplus of some 1% of GDP in 2009, compared to a surplus of around ¾% in 2008. The fiscal stance as presented in the programme can be considered as slightly restrictive. However, the December 2008 addendum to the stability programme provides technical information indicating a strong downward revision of the headline balance for 2009 by around 2½ percentage points of GDP to a deficit of 1.2% of GDP. This mainly reflects significantly lower growth assumptions in the addendum relative to the programme (around 2% of GDP in 2009) and the associated impact of automatic stabilisers, but also includes the budgetary impact from measures taken in response to the economic downturn less than 0.2% of GDP in 2009 (essentially from the accelerated depreciation of investments).

[4] The assessment notably takes into account the Commission Service's January 2009 interim forecast, but also other information that has become available since then.

(7) The main goal of the programme's budgetary strategy is to attain a structural surplus, that is, a cyclically adjusted surplus net of one-off and other temporary measures, of 1% of GDP at the end of the programme period. Thereby, the Netherlands would respect, throughout the programme period, its medium-term objective (MTO) for the budgetary position, which is a structural deficit ranging from 0.5% to 1% of GDP. The programme expects the headline budget surplus to fall from 1.2% in 2009 to 0.8% of GDP in 2010 and to rise again to 1.1% of GDP in 2011. The primary balance is expected to follow a similar pattern. Government gross debt, estimated in the programme at 42.1% of GDP in 2008, is projected to decline by 6 percentage points over the programme period. However, these projections were finalised before the government operations to stabilise the financial markets and therefore do not take them into account. These operations, such as the purchase of Fortis Bank Netherlands and bank recapitalisations, led to an increase of about 15 percentage points in the debt-to-GDP ratio of 2008. Specifically, according to the Commission services' interim forecast, the debt ratio reached 57.3% in 2008, declining to 53.2% in 2009 due to a loan repayment, before increasing again to 55.2% in 2010. According to the indications provided in the December 2008 addendum, the expected headline balance in 2009 and 2010 is now considered to be markedly below the targets set in the programme (indicating a deficit of 1.2% and 2.4% respectively). This suggests that the planned balance for 2011 may also be outdated.

(8) The budgetary outcomes projected in the programme are subject to (significant) downward risks. Most importantly, the macro-economic outlook is based on markedly favourable growth assumptions, as evidenced by recent weak economic data for example on industrial production. The economic growth difference with the Commission services' interim forecast amounts to 3¼% of GDP in 2009, which implies substantial budgetary risks and which is also reflected in the worsening government balance referred to in the addendum. Furthermore, the fiscal stimulus measures have not yet been taken into account in the budgetary targets of the programme although their impact is very small. Besides the direct budgetary impact, the measures involving guarantees pose a significant indirect risk, if these are extensively called upon. Finally, gas revenues can pose a risk for the budgetary outcome as they are based in the programme on a more optimistic oil price hypothesis than in the Commission services' interim forecast. In view of the negative risks to the budgetary targets and the sizeable guarantees given to the banking sector, there is a high risk that the evolution of the debt ratio will turn out less favourable than projected in the programme.

(9) 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.

(10) In 1994, the Netherlands introduced a trend-based budgetary framework, which has proved to be very successful[5]. While this framework was reaffirmed by the current government, some minor adjustments were made at the start of the government term in 2007.[6] More recently, in November 2008, the fiscal rule was modified in a way that all possible expenditures and non-tax revenues resulting from the interventions in the financial sector will not be part of the expenditure ceiling[7]. Furthermore, if, as a consequence of these government operations, the signal value[8] for the deficit of 2% of GDP is reached, no corrective measures will be taken. 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. There is no end date mentioned for this change in rules. The government also announced a reform of the methodology with respect to the budgetary treatment of non-tax gas revenues starting from 2012. For the period 2008-2011, the maximum amount of gas revenues that can be used for spending is fixed.

(11) With a view to stabilising the financial sector, 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 a back-up facility to a large financial institution.

(12) In line with the European Economic Recovery Plan agreed in December by the European Council, the Netherlands adopted fiscal support packages[9] for 2009. The measures of these support packages aim at fostering private investment through tax cuts and loan guarantees, protecting employment through the possibility of a temporarily lowering of hours worked, and improving the credit supply through guarantees. These measures are temporary, and should therefore not have an impact on the long-term sustainability of public finances. Furthermore, as the measures are also timely and targeted, they are generally in line with the general principles of the Commission Communication of 26 November 2008 on the EERP. Given the large

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5 This is evidenced by the fact that since 1994 the average budget deficit was 1.1% of GDP[5], 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.

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

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

8 The signal value for the government balance is meant to avoid the breach of the 3% of GDP deficit threshold. When the budgetary deficit is expected to surpass that value, corrective measures have to be taken, in order to prevent an excessive deficit from occurring. It was introduced in 2004, in reaction to the 2003 excessive deficit. Initially, the signal value was set at a deficit of 2.5% of GDP. In 2007, this was tightened to 2.0% of GDP.

9 In addition to the first support package, as presented in the addendum, the Netherlands adopted a second package in January, which mainly consists of guarantees and has no budgetary impact; these include an increase in the supply of export credit guarantees, guarantees to housing corporations and in bank lending guarantees.

commitments on the financial rescue packages, in spite of the favourable starting position of the public balance and debt and the projected severity of the downturn, the size of the support package is limited (0.2% of GDP). The update of the stability programme also includes a series of structural measures, which are part of the longer-term policy reform agenda but help 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.

(13) The fiscal stance, as measured by the change in the structural balance and taking into account the risks to the budgetary projections, is expansionary in 2009. This is broadly in line with the Stability and Growth Pact, which specifies that the adjustment should be higher in good economic times and could be lower in bad economic times. However, in light of the significant risks concerning the evolution of the government balance and debt, there is a risk that the deterioration in the public finances affects negatively their long-term sustainability. 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. Finally, taking into account the risks to the debt projections mentioned above, the debt ratio may not stay within the reference value over the programme period.

(14) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme provides all required and most of the optional data.

The overall conclusion is that the Netherlands has a sound budgetary position. Due to the projected sharp economic downturn, the government balance might enter again negative territory, after several years in surplus. The measures taken by the government in November last year and in January are generally in line with the European Recovery Plan, as they are temporary, timely and targeted. The budgetary impact of these measures is very limited. The government gross debt ratio increased significantly, as a result of measures taken to support the financial sector. There are important downward risks to the budgetary targets in the programme from 2009 onwards, largely due to the underlying markedly favourable economic scenario, which is already evidenced by recent data.

In view of the above assessment, the Netherlands is invited to implement measures in line with the EERP.

Comparison of key macroeconomic and budgetary projections

		2007	2008	2009	2010	2011
Real GDP (% change)	**SP Dec 2008**	**3.5**	**2¼**	**1¼**	**2**	**2**
	COM Jan 2009	3.5	1.9	-2.0	0.2	n.a.
	SP Nov 2007	*2¾*	*2½*	*1¾*	*1¾*	*n.a.*
HICP inflation (%)	**SP Dec 2008**	**1.6**	**2½**	**3¼**	**2**	**2**
	COM Jan 2009	1.6	2.2	1.9	1.8	n.a.
	SP Nov 2007	*1½*	*2¼*	*2*	*2*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Dec 2008**	**0.9**	**0.7**	**-0.1**	**-0.5**	**-0.6**
	COM Jan 2009[2]	2.1	2.1	-1.2	-2.2	n.a.
	SP Nov 2007	*1.6*	*2.3*	*2.7*	*n.a.*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Dec 2008**	**9.5**	**8.5**	**9.5**	**7.5**	**8.0**
	COM Jan 2009	9.4	7.7	5.9	5.4	n.a.
	SP Nov 2007	*6.6*	*6.5*	*7.2*	*7.5*	*n.a.*
General government revenue (% of GDP)	**SP Dec 2008**	**45.6**	**46.6**	**46.3**	**46.1**	**46.3**
	COM Jan 2009	45.6	46.8	46.1	45.6	n.a.
	SP Nov 2007	*45.9*	*46.9*	*46.9*	*47.2*	*n.a.*
General government expenditure (% of GDP)	**SP Dec 2008**	**45.3**	**45.4**	**45.1**	**45.3**	**45.2**
	COM Jan 2009	45.3	45.7	47.4	48.3	n.a.
	SP Nov 2007	*46.3*	*46.4*	*46.3*	*46.5*	*n.a.*
General government balance (% of GDP)	**SP Dec 2008**	**0.3**	**1.2**	**1.2**	**0.8**	**1.1**
	COM Jan 2009	0.3	1.1	-1.4	-2.7	n.a.
	SP Nov 2007	*-0.4*	*0.5*	*0.6*	*0.7*	*n.a.*
Primary balance (% of GDP)	**SP Dec 2008**	**2.6**	**3.4**	**3.30**	**2.9**	**3.1**
	COM Jan 2009	2.6	3.5	1.2	-0.2	n.a.
	SP Nov 2007	*1.8*	*2.7*	*2.7*	*2.7*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**SP Dec 2008**	**-0.1**	**0.8**	**1.3**	**1.1**	**1.5**
	COM Jan 2009	-0.8	0.0	-0.7	-1.5	n.a.
	SP Nov 2007	*-0.2*	*0.5*	*1.1*	*n.a.*	*n.a.*
Structural balance[3] (% of GDP)	**SP Dec 2008**	**-0.1**	**0.8**	**1.0**	**1.1**	**1.5**
	COM Jan 2009	-0.8	0.0	-1.0	-1.5	n.a.
	SP Nov 2007	*-0.2*	*0.5*	*0.7*	*n.a.*	*n.a.*
Government gross debt (% of GDP)	**SP Dec 2008**	**45.7**	**42.1**	**39.6**	**38.0**	**36.2**
	COM Jan 2009	45.7	57.3	53.2	55.2	n.a.
	SP Nov 2007	*46.8*	*45*	*43*	*41.2*	*n.a.*

Notes:

[1] Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2] Based on estimated potential growth of 1.7%, 1.8%, 1.3% and 1.2% respectively in the period 2007-2010.

[3] Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.3%of GDP in 2009; deficit-reducing, according to the most recent programme and in the Commission services' January interim forecast.

Source:

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