



Ministerie van Financiën

# Stability Programme of the Netherlands

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January 2010 Update

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## **Status of the January 2010 Update of the Stability Programme**

*This update of the Stability Programme is based on the (Supplementary) Coalition Agreement, the 2010 Budget Memorandum (Miljoenennota 2010), the 2009 Autumn Report (Najaarsnota 2009), the most recent short-term outlook provided by the CPB Netherlands Bureau for Economic Policy Analysis on 15 December 2009 and, finally, on technical projections by the Ministry of Finance for the years 2011 and 2012.*

*Following the approval of the November 2008 update of the Stability Programme by the Dutch Council of Ministers on 28 November 2008, it was sent to the European Commission on that same day and presented to Parliament on 4 December 2009. The approval of the December 2008 Addendum of the Stability Programme by the Dutch Council of Ministers was given on 19 December 2008, after which it was immediately sent to the European Commission and presented to Parliament on 6 January 2009. The 2008 update of the Dutch Stability Programme (including the Addendum), as well as the Recommendation for a Council Opinion on the 2008 update of the Dutch Stability Programme were discussed with Parliament on 5 March 2009. The final Council Opinion on the 2008 update of the Dutch Stability Programme was discussed with Parliament on 25 March 2009.*

*The 2009 update of the Dutch Stability Programme was approved by the Dutch Council of Ministers on 29 January 2010.*



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## Chapter 1 Implementation of the Excessive Deficit Procedure recommendations to the Netherlands

*The vast financial and economic crisis caused a rapid deterioration in the budgetary position. With an expected deficit of 4.9% of GDP in 2009, down from a surplus of 0.7% of GDP in 2008, the Netherlands is one of the twenty member states in the Excessive Deficit Procedure. In a first step to restore sound public finances, the Netherlands is firmly committed to implementing the recommendations of the Council adopted on December 2<sup>nd</sup> 2009. The government has presented a comprehensive strategy to address the economic crisis, to correct the excessive deficit, and to ensure the long-term sustainability of public finances. This chapter provides a broad overview of the policy measures that have been adopted or agreed to as well as the future policy objectives. More detail on the specific components of the strategy can be found in subsequent chapters of this update of the Stability Programme.*

### **Introduction**

The Netherlands entered the economic crisis from a position of strength. Economic growth was high, unemployment was low, and inflation moderate. Facilitated by a renowned set of budgetary rules, the budget balance had been brought in surplus. In fact, the structural surplus of roughly 1% of GDP as projected in the Budget Memorandum 2009 meant that the Netherlands outperformed the Medium-term Objective (MTO) by a wide margin.<sup>1</sup> The debt ratio was low and decreasing, and reached a historically low figure in 2007.

Clearly, the crisis has changed the outlook dramatically. In the second half of 2008, the government had to take unprecedented action to stabilise the financial sector in order to limit spillovers to the real economy. Subsequently, on 25 March 2009, the government presented a comprehensive supplementary policy agreement titled ‘Working on the Future’ as the main response to this economic crisis. The agreement contains measures to support the economy in the short-term, while repairing the budgetary position in the medium and long-term. It is consistent with stabilising the economy in 2010, starting fiscal consolidation in 2011, and with further improving the budgetary position thereafter.

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<sup>1</sup> The MTO for the Netherlands was a structural balance between -1% and -0.5% of GDP (currently it is between -0.5% and +0.5% of GDP).

### **Box 1.1: The Dutch response to the economic crisis – A general overview**

<b><i>Short-term: Stabilising the economy</i></b>
<ul style="list-style-type: none"><li>▪ Interventions in financial sector (13.9% of GDP);</li><li>▪ Government guarantees (30% of GDP);</li><li>▪ Stimulus package (1.4% of GDP);</li><li>▪ Automatic stabilisation (10.5% of GDP).</li></ul>
<b><i>Medium-term from 2011: Restoring public finances</i></b>
<ul style="list-style-type: none"><li>▪ Start consolidation in 2011, conditional on economic recovery;</li><li>▪ Budget deficit below 3% of GDP in 2013, in line with the Council Recommendation;</li><li>▪ Further consolidation towards Medium-term Objective, laid down in Deficit Reduction Act;</li><li>▪ Identification of comprehensive consolidation measures, Fundamental Budget Review;</li><li>▪ Budget path and policy 2011-2015; Budgeting Framework Commission.</li></ul>
<b><i>Long-term: Improving sustainability</i></b>
<ul style="list-style-type: none"><li>▪ Increasing the retirement age to 67 (0.7% of GDP);</li><li>▪ Improving efficiency in health care (0.4% of GDP);</li><li>▪ Higher taxes on residential real estate with a value above € 1 mln (0.2% of GDP).</li></ul>

#### ***Overview of measures***

##### Measures for the short-term: fiscal stimulus in 2009-2010

The government's 2010 Budget Memorandum of September 15, 2009 allows the automatic stabilisers to operate freely. As will be discussed in chapter 8, cyclically sensitive expenditure will be kept outside the expenditure ceilings. The Budget Memorandum does not contain additional stimulus measures but specifies the implementation of the policy packages to stimulate the economy in 2009 and 2010 by cumulatively 1.4% of GDP. Measures taken to support the economy are inspired by and fully in line with the European Economic Recovery Plan (EERP) as adopted by the European Council in December 2008. Moreover, in line with the EERP, the vast majority of the measures are timely, targeted and temporary, and designed to make the economy more innovative and greener.

##### Measures for the medium-term: consolidation starting in 2011

In line with the recommendation of the Council, the government has decided to withdraw the stimulus measures amounting to 0.5% of GDP in 2011, provided that the economy has sufficiently recovered from the crisis. The latest economic forecast by the CPB Netherlands Bureau for Economic Policy Analysis (CPB)

provides a first indication that this will be the case. In that scenario, in addition to the withdrawal of the stimulus measures, expenditures will be cut further by €1.8 bln. Moreover, the government intends to moderate wages in both the private and (semi-) public sector. Calculations show that the measures that have already been adopted together with the other agreements aimed at spending restraint in 2011 and in the following years improve the sustainability of public finances by 0.5% of GDP. As will be discussed in chapter 8, the new Deficit Reduction Act will ensure further budgetary consolidation over the medium-term. Moreover, as will be explained in greater detail below, the Fundamental Budgetary Review (FBR) will provide the government with necessary input for a durable return to sound and sustainable public finances. Major decisions regarding the FBR are foreseen in June 2010.

#### Measures for the long-term: sustainability measures

Correction of the excessive deficit is only a first step on the road to achieving sustainable public finances and will need to be complemented by further structural measures to improve the budgetary position in the medium and long-term. The government already envisages measures that narrow the sustainability gap by 1.3% of GDP. To this end, politically difficult structural reforms that also address the budgetary costs of ageing have been submitted to Parliament. The government has taken a major step by increasing the statutory retirement age from 65 to 66 in 2020 and to 67 in 2025, and by presenting cost-containing measures with respect to healthcare. Moreover, by abolishing the indexation of the threshold for houses valued at over €1 mln, an increasing number of houses will be subject to a higher level of taxation, thereby implicitly reducing the overall tax subsidy on mortgages.

#### ***The exit strategy towards 2013***

Economic recovery, the phasing out of the stimulus package, and the consolidation measures that are planned for the medium-term, such as the €1.8 bln cut in expenditures, will help to reduce the deficit to 5.0% of GDP in 2011 in our baseline. Ahead of a new medium-term outlook by the CPB, to be presented in May, the forecast for the years 2011-2012 presented in this update of the Stability Programme is primarily a technical extrapolation, including only policy measures that have already been adopted. On this basis, the structural deficit in 2012 is expected to be 3.6% of GDP. In order to reduce the actual deficit to less than 3% of GDP in 2013, the Excessive Deficit Procedure (EDP) Recommendations to the Netherlands prescribe, amongst others (see box 1.2), an average annual structural fiscal effort of ¾% of GDP during the period 2011-2013.



**Box 1.2: Main elements of the Council Recommendation to the Netherlands**

(1) Recognising that the Dutch budgetary position in 2009 resulted from measures amounting to 1% of GDP, which were an appropriate response to the European Economic Recovery Plan, and the free play of automatic stabilisers, the Dutch authorities should implement the fiscal measures in 2010 as envisaged in the 2010 budget and, starting consolidation in 2011, put an end to the present excessive deficit situation by 2013.

(2) The Dutch authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the Dutch authorities should:

(a) ensure an average annual fiscal effort of  $\frac{3}{4}$ % of GDP over the period 2011-2013, which should also contribute to halting the rapid rise of the government gross debt ratio, which is forecast to breach the reference value;

(b) specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

(3) The Council establishes the deadline of 2 June 2010 for the Dutch government to take effective action to implement the fiscal measures in 2010 as envisaged and to outline the consolidation strategy in some detail that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

The Dutch authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the Stability Programmes which will be prepared between 2010 and 2013.

Furthermore, the Council invites the Dutch authorities to implement reforms with a view to raising potential GDP growth.

The government has put in place a credible strategy to complement the measures already taken, in order to ensure correction of the excessive deficit by 2013 and to further improve the budgetary position towards the MTO thereafter. This strategy is built on three pillars, each bringing forward concrete results before

summer. The three pillar strategy is illustrative of the fundamental approach the government takes towards fiscal consolidation and structural reform, which is needed in light of the large deterioration of the budgetary position.

1) Fundamental Budget Review (FBR): In reaction to the budgetary deterioration stemming from the crisis, the government has decided to establish 20 high-level working groups to identify structural reform and saving options for a broad spectrum of policy areas. Simultaneously with these 20 groups, a study on the structure of the tax system is being conducted.

For each policy area covered by the 20 high-level groups, at least one scenario will need to be developed that enables a 20% structural reduction in net spending (including tax expenditures) in that particular policy area through structural reform. As a consequence, potential savings totalling €30-40 bln will be identified and presented to the government. This substantial savings potential is explained by the fact that the groups present options, not fixed solutions, and that, rather than dealing with relatively straightforward across-the-board expenditure cuts, the FBR looks into genuine structural reform options that will also improve long-term sustainability.

2) The budgetary framework: The Netherlands has a sophisticated and well-tested set of budgetary rules in place. The 'trend based budgetary policy' has provided the Netherlands with an excellent track record and has facilitated achieving a sound budgetary position at the outset of the crisis. Such credible and transparent rules will be instrumental in achieving the necessary fiscal consolidation in the coming years. Moreover, in the budgetary process, the government bases its decisions on the analysis and economic forecasts of an independent institution (the CPB), thus ruling out any bias in the growth projections and in the foreseen impact of consolidation efforts. The CPB will present its new medium-term outlook in May, which will serve as a basis for the government's medium-term consolidation efforts.

To complement the highly regarded budgetary framework, the government has recently submitted to the Council of State a Deficit Reduction Act to legally enforce the budgetary adjustment. The new rule, to be enshrined in national law, ensures further progress towards the MTO after the future abrogation of the Excessive Deficit Procedure for the Netherlands. The Deficit Reduction Act also contains provisions to ensure improvement of the budget balance of local governments as of 2011.

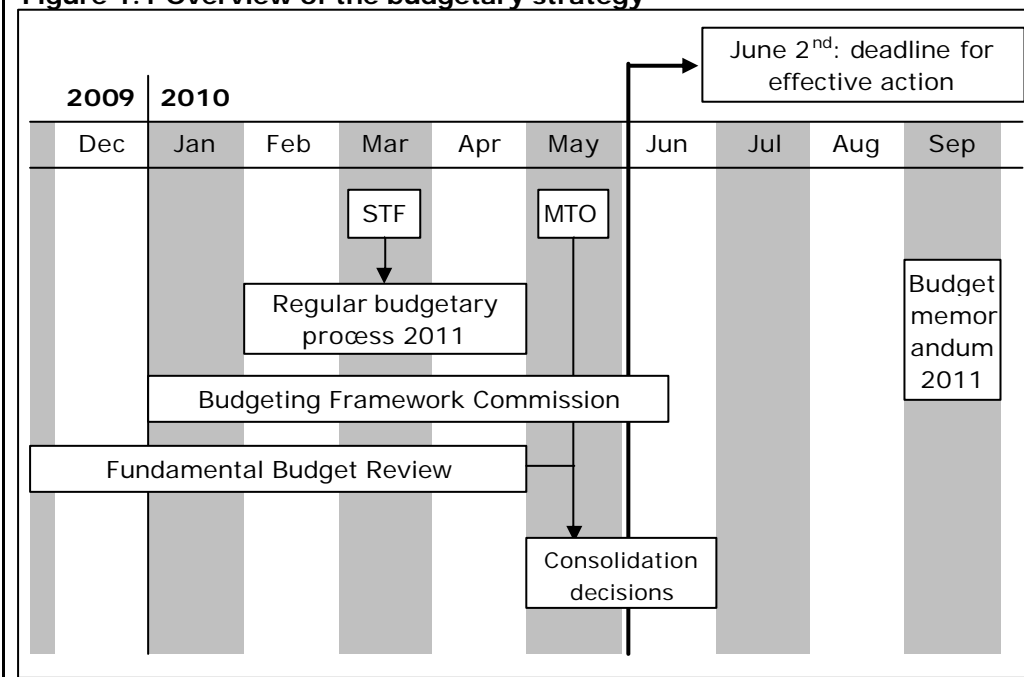
3) The Budgeting Framework Commission (BFC): Every four years, the Budgeting Framework Commission (*Studiegroep Begrotingsruimte*) - consisting of experts of the ministry of Finance, other departments, the central bank, and the CPB - advises the upcoming government on how to handle the challenges to budgetary policy. This Commission roughly focuses on two separate questions: what budgetary targets should a new administration pursue? And what alterations to the current budgetary policy framework are advisable?

The next BFC advice is expected before the summer of 2010. Given the inevitable adjustments that will have to be made to restore the budgetary position, the main focus of the BFC will be on the (speed of the) recovery of public finances in the aftermath of the financial and economic crisis. This extensive and comprehensive study is performed against a background of trends in government revenues and expenditures, such as the impact of population ageing, autonomous growth of several tax expenditures, and the increase in revenues and expenditures relative to GDP growth.

**Box 1.3: The process underlying the budgetary strategy**

The commitment of the government to sound and sustainable public finances is reflected in the comprehensive process put in place towards durable fiscal consolidation. Key features of the government's three pillar strategy are: fundamental analysis, independent input, and high-level advice. The 20 groups of the Fundamental Budget Review have been tasked to work within a tight time schedule, illustrative for the urgency the government attaches to this process, and will present the results of their in-depth analysis by May 1<sup>st</sup>. The study on the structure of the tax system is proceeding along the same time track. The Budgeting Framework Commission has also started and is expected to present its report on the budgetary policies and targets for the medium-term in June at the latest. Moreover, the CPB publishes a short-term economic forecast (STF) in March; the CPB's medium-term outlook (MTO) for the period 2011-2015, to be presented in May, will provide another source of independent input on the budgetary outlook. Hence, already before summer, the three pillars will come together and lay a sound basis for decisions on the future course of budgetary policies. On this basis, the government is committed to deciding in June how to supplement the already planned consolidation efforts with additional measures in order to reduce the budget deficit to below 3% of GDP in 2013 and to further improve the budget balance thereafter.

**Figure 1.1 Overview of the budgetary strategy**



### **Development of the budgetary position**

Compared to the projections in the previous update of the Stability Programme, the EMU balance has deteriorated by more than 6 percentage points of GDP in 2009 and 2010<sup>2</sup>. This is largely due to the effects of the automatic stabilisers. Tax revenues and social security contributions have decreased considerably, while expenditures on unemployment and interest payments have increased. As in the previous downturn, the Dutch budgetary position proves to be very cyclical. The stimulus package had a further impact on the budget balance. While, according to ESA95, the interventions in the financial sector do not directly burden the budget balance, figure 1.2 shows that these interventions did have a large upward impact on the debt ratio.

**Figure 1.2 The impact of the crisis on the debt ratio (% of GDP)**

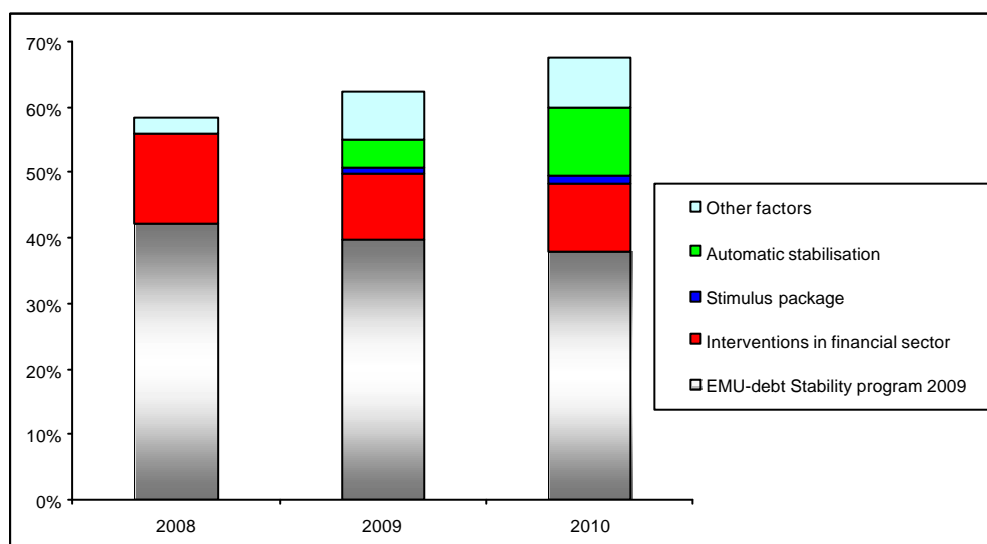


Table 1.1 provides a baseline scenario for the expected development of the Dutch budgetary position. To the extent that measures have already been adopted, they are taken into account in this baseline scenario. Future policy objectives underscore the government's commitment, but they can only be included in the baseline once specific measures have been adopted. The baseline indicates to what extent the deficit reduction is already firmly in place and how much still needs to be achieved. Once again it must be noted that the years 2011-2012 are based on a technical exercise performed by the Ministry of Finance.

<sup>2</sup> Please note that the figures for the budget balance in 2009 and 2010 are the Ministry of Finance's own estimates, based on the most recent short-term outlook provided by the Netherlands Bureau for Economic Policy Analysis (CPB) on 15 December 2009.

**Table 1.1 Key figures for the Netherlands**

(% GDP)	Short-term outlook			Assumed normalisation of the business cycle including already adopted policies	
	2008	2009	2010	2011	2012
Economy					
Real GDP growth	2.0	-4.0	1.5	2.0	2.0
Unemployment (% labour force)	3.9	5.0	6.5	6.5	6.5
Growth of relevant foreign markets*	1.6	-12.8	7.5	6.5	6.5
Government balance					
Actual balance**	0.7	-4.9	-6.1	-5.0	-4.5
Output gap	2.3	-3.2	-2.7	-2.2	-1.6
Structural balance**	-0.4	-3.5	-4.7	-3.8	-3.6
Debt	58	62	67	70	73
EMU reference value: -3%					
MTO Netherlands: between -0.5% and +0.5%					
Effort					
Actual balance – including already adopted policies					-4.5
<i>Additional Effort needed over the period 2011-2013: actual deficit 2013 &lt; 3%</i>					1.5
Structural balance – including already adopted policies					-3.6
<i>Additional Effort needed over the period 2011-2013: structural balance within MTO</i>					3.6

\* Taken to be equivalent to the Dutch 'Relevant handelsvolume' (volume of relevant world trade).

\*\* The figures for 2011 and 2012 are not to be interpreted as budgetary targets, but as technical outcomes based on a no-additional-policy scenario. The government will start considering further measures in June.

While the measures taken help to reduce the deficit, the table shows that additional efforts will be needed to durably reduce the deficit to less than 3% of GDP and to bring the structural balance in line with the MTO of at least -0.5% of GDP. The government's three pillar approach will provide a comprehensive basis for taking fundamental decisions to ensure durable fiscal consolidation. The large deterioration of public finances caused by the crisis and the looming cost of ageing warrant such a fundamental approach to restoring sound and sustainable public finances.

### **Concluding remarks**

The global economic crisis has had a relatively large impact on the Dutch economy. Nevertheless, the Netherlands is in a good position to face the challenges ahead. The measures taken in response to the crisis, together with the use of automatic stabilisers and the interventions in the financial markets, are providing a necessary stop-loss provision in reaction to the economic slump and

financial distress. Going forward, consolidation measures together with the anticipated favourable impact on the budget from automatic stabilisers in the coming years are being complemented with structural reforms aimed at restoring and safeguarding sound public finances in the longer term.

The Netherlands has thus put in place a credible and reliable exit strategy that will form the basis for its commitment to bring the budget balance to below the 3% deficit threshold by 2013. The recent Deficit Reduction Act ensures that consolidation efforts continue after abrogation of the Excessive Deficit Procedure towards the MTO. This law and more generally the three pillar strategy put in place by the government, the measures already taken, the rules-based budgetary framework, and the well-established track-record provide reassurance that the Netherlands will deliver on its budgetary objectives.

## Chapter 2 Overall policy framework and objectives

*By international comparison, the Netherlands has a large financial sector and a very open economy. It therefore comes as no surprise that the Netherlands was hit relatively hard by the economic crisis. This chapter provides an overview of the policy actions that were taken to avoid financial collapse and to stabilise the real economy. Moreover, this chapter elaborates on measures planned for the medium and long-term.*

### **Introduction**

Since last year's Stability Programme update, the economic situation has changed markedly. 2009 will show the biggest drop in production since the Great Depression in the 1930s. The contraction of GDP is expected to amount to 4% in 2009 as a consequence of the adverse developments in both the financial sector and the real economy. The government has taken various measures for immediate crisis management, so as to alleviate the negative impact of the crisis on the real economy, while at the same time it has spelled out important elements for the exit strategy towards sustainable public finances in the medium to longer term. As in other countries, these policy measures lay the foundations for economic recovery. Currently growth figures are improving. The quarter-on-quarter growth in the third quarter of 2009 is estimated at 0.5% of GDP<sup>3</sup>, which is the first positive quarter-on-quarter growth figure since the second quarter of 2008. Nevertheless, the economic outlook is still highly uncertain. More details regarding the macroeconomic outlook can be found in Chapter 3.

### **Short-term: measures to support the financial and real economy**

In response to the economic crisis, the government has taken the necessary measures and intervened in the financial markets on several occasions in order to safeguard the stability of the financial sector. Box 2.1 presents the main interventions in a concise manner. Chapter 4 contains more detailed information, also regarding the budgetary impact of these measures.

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<sup>3</sup> Source: Statistics Netherlands (CBS)



**Box 2.1 : Overview of main government interventions in financial markets**

Both with respect to the recapitalisation efforts as well as the illiquid asset support, the Netherlands was among the first to implement the policies that had been agreed to by the Ecofin Council. In designing these measures, the Netherlands complied with the directives set by the European Commission and the Eurosystem. Market-compatible terms and conditions were selected so as to prevent misuse and to preserve a level playing field.

In October 2008, the Netherlands acquired the Dutch divisions of Fortis (including the share that Fortis held in ABN AMRO). ING, Aegon, and SNS Reaal received capital injections to restore their capital position. In return, the State received securities, comparable to shares, for the counter value of the injections. The coupon on the securities was fixed at a minimum of 8.5%, but will be paid out only if a dividend was paid in the preceding year. Since SNS Reaal and Aegon have announced their intentions to make early repayments, the overall return on the securities will most likely be higher than 8.5% due to the specific requirements concerning the (early) repurchase of the securities.

The Illiquid Assets Back-up Facility covers 80% of ING's Alt-A mortgage securities. The Dutch State therefore will participate in 80% of any results of the portfolio, thereby effectively taking away the undue burden of an illiquid market.

As part of the overall framework, a total amount of € 200 bln of debt guarantees was envisaged, if necessary. Of this amount, € 47.2 bln was effectively guaranteed. Guaranteed debt has been declining since August 2009 by €3.1 bln.

In line with the agreement in the October 2008 Ecofin meeting to raise the coverage under the deposit insurance scheme, coverage under the Dutch deposit insurance system was increased to EUR 100.000. This coverage stands until end 2010 in anticipation of the new EU Directive.

In line with the European Economic Recovery Plan, the government intervened forcefully to counteract the effects of the crisis on the real economy. An initial economic stimulus package dating from 21 November 2008 was aimed at supporting the business sector by i) temporarily allowing accelerated depreciation (hence temporarily alleviating the tax burden), ii) stimulating the provision of credit to small and medium enterprises (SMEs) iii) reducing the period of payment by government agencies wherever possible, and iv) lowering the corporate tax for SMEs. This initial package also included measures for the labour market aimed at reducing the risk and duration of unemployment. Labour mobility centres were set up with the intention to improve the link between supply and demand in the

labour market, and businesses were temporarily allowed to use a reduced working hours arrangement. In addition, the government had already decided not to introduce the planned VAT-increase of 1 percentage point, while not reversing a planned reduction of the unemployment premium to 0% for employees.

On 16 January 2009, the government announced a second stimulus package. The export credit insurance (EKV), the SME Guarantee Scheme and Growth Facility were expanded to support the functioning of the credit market. In addition, the scope of the Social Housing Guarantee Fund was broadened and building plans for health care institutions were supported.

#### **Box 2.2: Overview of the stimulus package**

In view of negative growth prospects and in addition to the automatic stabilisers, the Dutch government decided to launch an economic stimulus package for 2009 and 2010. Starting in 2009, the Dutch government implemented timely, targeted and temporary stimulus measures. In each of these two years, on average, around €3 bln will be invested by the central government. The stimulus package has three goals:

##### *1. Mitigate the direct effects of the crisis*

The Dutch government and the 'social partners' (employers and labour unions) formulated a joint approach for dealing with the situation on the labour market in the immediate future. An important measure in this respect was the introduction of part-time unemployment benefits. Companies that are confronted with temporarily lower demand can temporarily place employees in part-time unemployment schemes. This scheme prevents the dismissal of workers as a result of the crisis whose capacity will be needed again as the crisis abates. The Dutch government also made additional resources available for improving the labour market situation for young people, just as it temporarily raised spending on education and assistance for people with unmanageable debts.

##### *2. Stimulate direct demand*

The Dutch government made additional resources available for extra investments in infrastructure, restoration of monuments and the maintenance of health care and school buildings. Because most of these projects can be executed quickly, there is a direct effect on demand. Additional options were made available for companies to increase their liquidity, for instance by the possibility to 'carry back' losses and through tax deductions for investments in innovation and energy-saving technologies.

### 3. Stimulate innovation and a sustainable economy

To stimulate innovation and enhance sustainable economic development in the future, the government made funds available for new innovations in 'sustainable technologies' like electric cars, wind-energy in the North Sea and energy saving in households. These innovations are expected to boost productivity in the medium-term.

Finally, local governments will spend an estimated €1.5 bln on stimulating economic activity in 2009-2010.

Table 2.1 shows the details.

**Table 2.1 Stimulus package in 2009 and 2010 (in € bln)**

	2009	2010
<b>Stimulus package central government</b>	<b>2.2</b>	<b>3.4</b>
- Labour market and education	0.6	0.9
- Infrastructure/housing/maintenance	0.6	1.2
- Liquidity/credit facilities for companies	0.7	0.6
- Sustainable economy	0.3	0.6
<b>Stimulus package local governments</b>	<b>0.5</b>	<b>1.0</b>
<b>Total</b>	<b>2.7</b>	<b>4.4</b>

#### **Medium-term: fiscal consolidation**

A third package was announced on 25 March 2009 (see box 2.2). This policy package was designed to supplement the coalition agreement, named 'Working on the Future'. In this policy package, the government presented its main response to the global economic crisis. The policy measures do not only focus on crisis management in the short-term, but also spell out the building blocks for a credible exit strategy in order to return to healthy and sustainable public finances in both the medium and longer term.

In its policy approach to tackle the economic crisis, the government acknowledged the necessity for fiscal stimulus in the short-term. At the same time, the government recognised that the key priority for the medium and long-term is restoration of sound public finances, not in the least in view of the inevitable impact of the ageing population. Government debt rose substantially within a short time frame. This was because of the support provided to the financial

system and the growing budget deficit mainly as a result of deteriorating tax revenues. The substantial debt increase poses a considerable challenge to public finances. The government is committed to start working towards restoration of sound public finances and the reduction of the budget deficit in 2011, provided that economic growth is self sustained by then and the economy has sufficiently recovered. The latest economic forecasts by the CPB provide a first indication that this will be the case.

The measures announced and adopted in the supplementary policy agreement constitute a credible start of the Dutch exit strategy that is needed to return to sustainable public finances. Moreover, the necessary fiscal consolidation will be enforced by a new national budgetary law, the Deficit Reduction Act. To achieve the fiscal consolidation, difficult decisions will be inevitable. In this light, the government announced the launch of a Fundamental Budget Review (FBR) in its 2010 Budget Memorandum released on September 15, 2009. The aim of the FBR is to facilitate taking these difficult decisions by identifying the consolidation measures and their possible consequences. Chapter 6 provides more information on the FBR.

### **Box 2.3: Medium-term: restoring public finances from 2011**

Starting from 2011, the key priority is to ensure a return to sound public finances. In 2011, the government will therefore start consolidation by eliminating the stimulus package. In addition, expenditures will be cut further by €1.8 bln. Apart from these measures already decided upon, the government intends to moderate wages in the public sector. Calculations show that the already adopted measures, together with other agreements aimed at spending restraint in 2011 and in the following years, improve the sustainability of public finances by 0.5% of GDP.

#### ***Lower expenditures***

A large part of the expenditure cuts in 2011 will deal with the allowances of the central government makes to local governments (provinces and municipalities). Normally (before 2009), the development of the contribution to local governments is proportional to the development of the central governments expenditure volume. During the period of the stimulus package (and taking into account the extra expenditures of the central government as a result of unemployment rise and increasing interest payments) this proportion can be questioned. On April 15 2009 the central government with municipalities and provinces agreed to lower the central government contributions by € 650 mln per year, starting in 2011. Part of the agreement was that local governments will be rather reserved with increasing the local taxes. This governmental agreement was signed by all

stakeholders. As a result, municipalities and provinces will have to scrutinize their expenditures starting in 2011, which is already foreseen in their most recent budget proposals. The contribution to the provinces will be reduced by an extra €300 mln per year starting in 2011. The impact of this additional cut will be felt immediately by a number of provinces. Even for those who currently enjoy some room for manoeuvre, the reduction will impinge on future spending as the reduction is of a permanent nature.

On budgetary policy, municipalities and provinces are bound by the new Deficit Reduction Act (see chapter 8), which states that the share of local governments in the EMU deficit may not exceed 0.5% of GDP in any given year. Enshrining this obligation in law is a novelty and an extra safeguard to make sure that the cuts in the contributions of the central government to the local governments are effective. It was further agreed that any additional cuts in the contribution to local governments will be subject of discussion at a later date, pending the results of the announced budget reviews (see box 6.1).

The other consolidation measures are focused on raising efficiency (operational management, productivity cuts, water management) and aim to reprioritise spending in several areas (infrastructure, education, international policy). All these measures have already entered the budgets of the different ministries. The table below gives an overview of all the consolidation measures that will be implemented.

<b>Overview consolidation measures in 2011</b>	<b>Bln(€)</b>
<b>Civil service organisation</b>	
Agreement with Municipalities and provinces on lower central government contributions	0.65
Recalibration financial relation of central government and provinces	0.30
More efficient and rational water management	0.10
Economizing operational management	0.07
Productivity costs (excl. High Colleges of State, defence, education, police and health care)	0.07
Extrapolation vacancies defence	0.02
<b>Reprioritizing of several budgets</b>	
Infrastructure Fund	0.12
Several measures Education, Culture, Science	0.10
Cutbacks on combating terrorism (excl. defence)	0.02
International policy (Non-ODA budget)	0.01
Diverse	0.13
<b>Other</b>	
Reduction inflation correction (2011 block)	0.10
Reduction of settled expenses Coalition Agreement (2011 block)	0.11
<b>Total consolidation package 2011</b>	<b>1.80</b>

Although current projections indicate that growth will improve, it is noted once more that, should 2011 still be marked by negative economic growth prospects, the Dutch government reserves the option to prolong its temporary stimulus measures. In this case the stimulus package will be prolonged in 2011, thereby preventing the expenditure cuts from upsetting the economic recovery.

**Long-term: sustainability of public finances**

In addition to achieving a sound budgetary position in the medium-term, the government considers it important to take further measures to safeguard long-term sustainability of public finances. As such, the government envisages a number of ambitious measures that aim to close the sustainability gap by 1.3% of GDP. This includes the increase in the statutory retirement age to 67, with an allowance for the more physically demanding professions, which is an important first step in the efforts to reduce the sustainability gap. Moreover, the € 1 mln cut-off point for determining the percentage of the taxable base value of a personal residence will not be indexed. As a result, an increasing number of houses will be subject to a higher level of taxation, thereby implicitly reducing the overall tax subsidy on mortgages.

The supplementary policy agreement states that acute care will contribute towards the sustainability of public finances by lowering its expenditures by 0,4% of GDP. At least 0.2% will be achieved by reforming the health care allowance benefit, a tax credit to lower and middle income families. For the remaining part, additional measures will be taken to limit acute care expenditure by another 0,2% of GDP. The table below gives an overview of the contributions of these sustainability measures on the sustainability of public finances.

**Table 2.2 Effects of the sustainability package on the long-term sustainability of public finances**

	Effect on sustainability (in % of GDP)
Retirement age 65 -> 67	0.7%
Health care expenditures	0.4%
Higher taxes on houses > € 1 mln	0.2%
<b>Total</b>	<b>1.3%</b>

Chapter 7 will elaborate on the outlook for long-term sustainability of public finances.

## Chapter 3 Economic outlook

*Recent forecasts by the independent Netherlands Bureau for Economic Policy Analysis (CPB) paint a picture of a recovering Dutch economy, with GDP growth improving substantially from -4% in 2009 to 1.5% in 2010. Driving forces are the vigorous stimulus measures, improvements in the financial markets, and particularly the increase in relevant world trade. While the recovery is projected to be relatively broad based, it is still fragile and the risks and uncertainties surrounding the outlook remain high.*

### **Introduction**

This chapter gives an overview of the underlying macroeconomic assumptions. The baseline scenario for the economic outlook presented in this chapter is based on the most recent short-term outlook provided by the CPB on 15 December 2009. The estimates for the budget balance are calculated by the Ministry of Finance. In the absence of a representative medium-term outlook, separate calculations were made for the years 2011 and 2012 by the Ministry of Finance. These projections are based on technical assumptions and only incorporate policies that have already been adopted. Given the technical nature of the projections, they are surrounded by great uncertainty. Although the most recent data show signs of an initial recovery, the main question still is to what extent the recovery will be self-sustained. While the unrest on the financial markets has subsided, there is no guarantee of a complete normalisation in the coming years. On the other hand, the substantial government measures may well be more effective than expected and restored confidence may provide a bigger boost to economic activity than foreseen, thus allowing for stronger economic recovery. The sensitivity analysis in chapter 5 will present alternative scenarios in order to account for possible down- and upward risks.

### **World economy and technical assumptions**

The distress on the financial markets after the bankruptcy of Lehman Brothers in September 2008 has declined significantly. In great part, this is due to the exceptional measures taken by both central banks and governments. Market parties no longer consider the full collapse of the financial system as a likely possibility and the decline in interest rate differentials between corporate and government bonds over the past months suggests that uncertainty has decreased. The situation is far from normal, however; many institutions are still suffering from badly performing loans, and the size of the balance sheets of central banks has strongly increased. As such, the situation is still markedly different compared to before the economic crisis.

2009 will show the biggest drop in global production since the Second World War. World GDP is estimated to have contracted by 1%, while GDP in the euro area is expected to have dropped by 4%. However, in 2010 the outlook for the world economy improves, underpinned by positive quarter-on-quarter growth in the third quarter of 2009 for the euro area, the U.S. and Japan, and the expectation that this trend will continue in the fourth quarter and beyond. The recovery is driven mainly by expansionary fiscal and monetary policies, an expected improvement in financial markets, and a positive impulse from stock build-up by companies. Despite rising energy prices, inflation remains subdued, mainly as a result of increasing unemployment in combination with low unit labour costs. On average, after adverse developments in 2009, unemployment and government deficits in the euro area are projected to rise further in 2010.

Table 3.1 displays the external assumptions underlying the Dutch baseline scenario. These external assumptions are in line with the assumptions that the European Commission used for the Autumn Forecasts. The economic forecast for the Netherlands of December 2009 by the CPB is compared with the Commission's 2009 Autumn Forecast at the end of this chapter.



**Table 3.1 External assumptions**

	2008	2009	2010	2011	2012
Short-term interest rate (annual average)	4.6	1¼	1	1.5	2
Long-term interest rate (annual average)	4.3	3¾	3¾	4	4
USD/€ exchange rate (annual average)	1.47	1.40	1.49	1.49	1.49
Nominal effective exchange rate	3.7	-¾	2½	0	0
World GDP growth	2.8	- 1	3½	4	4
EU GDP growth*	0.6	- 4	1½	2	2
World GDP growth excluding EU	3.3	-¼	4¼	5	5
Growth of relevant foreign markets**	1.6	-12¾	7½	6½	6½
World import volumes, excluding EU	2.5	-12¼	10	10	10
Oil prices (Brent, USD per barrel)	97	62	77	77	77

Source: For 2009 and 2010: all figures taken from or consistent with CPB Newsletter 2009/4; For 2011 and 2012: Ministry of Finance's own estimates

\* Taken to be equivalent to euro area GDP growth (as differences e.g. in latest Commission Services forecast are benign)

\*\* Taken to be equivalent to the Dutch "*relevant wereldhandelsvolume*" (volume of relevant world trade).

### ***Cyclical developments and prospects according to the baseline***

The Dutch economy was hit relatively hard by the economic crisis due to the size of the financial sector and the openness of the economy. The latest estimates from the CPB show that the Dutch economy contracts by 4% in 2009. The CPB expects the economy to rebound in 2010, as growth is forecast at 1.5%. This means, however, that the Dutch economy is still performing below its pre-crisis potential growth path. Compared to a scenario where growth would have continued along its pre-crisis growth path after 2008 (i.e. 2% per year), the economic crisis puts GDP in the Netherlands in 2010 approximately 6% below this level.

The contraction of the Dutch economy in 2009 manifests itself in nearly all major demand categories, as can be seen in table 3.2. Private consumption, investment and exports all show a pronounced decline and as such contribute to the contraction. The only exception is government spending, which grew as a result of the stimulus measures, the working of the automatic stabilisers, and an increase in healthcare expenditures. The positive growth forecast in 2010 of 1.5% GDP is

primarily driven by export growth. On balance, domestic demand does not contribute to growth at all. In what follows, the individual demand categories will be covered in somewhat greater detail.

**Table 3.2 Contributions to real GDP growth, 2008-2010**

	2008 <i>share in %</i>	2008 <i>contribution to real GDP growth</i>	2009 <i>contribution to real GDP growth</i>	2010 <i>contribution to real GDP growth</i>
		<i>in percentage points</i>		
Private consumption	33	0.3	-½	0
Residential investment	5	0	-¾	-¼
Gross fixed capital formation	6	0.6	-1	0
Government spending	25	0.6	¾	¼
Exports	33	0.5	-2½	1½
Total (real GDP growth) <i>rate of change in %</i>		2	-4	1½

Source: CPB Newsletter 2009/4

Exports account for roughly one third of the growth of total added value in the Netherlands. As a result, global economic developments are of great importance. For 2009, the CPB expects relevant world trade to have decreased by 12¾%, whilst for 2010 a rebound of 7½% growth is foreseen. The development of Dutch exports is by and large in line with relevant world trade developments; exports are expected to have decreased by 8¾% in 2009 and to increase by 4¾% in 2010.

The Dutch stock market index, the AEX, fell by more than 50% between May 2008 and March 2009. The rebound of the stock market since March has only partially recovered this loss. House prices declined slightly, while profit sharing dropped considerably. Triggered by this considerable wealth loss, diminished confidence in the economy and a fear of losing jobs, households have been increasing their savings in 2009. As a result, private consumption is estimated to have declined by 2½% in 2009, even though the relatively positive development of purchasing power has helped to mitigate the shrinkage.

In 2010, private consumption is expected to grow slightly, by ¼%. The development in real income and positive developments in private wealth will have an upward effect on consumption, but, owing to still hesitant consumer confidence, consumers will remain cautious with their spending. Consumer confidence, however, has been gradually increasing since early 2009, so that by 2010 households are not expected to be increasing their savings any further, so that the savings rate will stabilise.

Private investment decreased dramatically in 2009, by 15¾%. Capacity utilisation dropped rapidly as a result of a sharp decline in aggregate demand. Consequently, businesses felt little need to invest in production expansion. Moreover, the fact

that the Dutch labour market was very tight at the beginning of the crisis made employers relatively hesitant to lay off employees, so that profit margins came under pressure. This development also rendered investments less appealing. Finally, the acceptance criteria for credit were tightened by credit institutions, exacerbating the major decrease in projected total business investments in 2009. The sharp drop in production in 2009 has led to overcapacity which is not expected to be eliminated by 2010, despite the fact that production in the private sector is forecast to grow by 2%. As a consequence, businesses remain reluctant to invest. Therefore, private investment is expected to shrink by an additional 7¼% in 2010 from the already low level in 2009.

Government spending is forecast to increase in both 2009 (+2¼%) and 2010 (+¾%), mainly as a result of the upward trajectory of health expenditures. Other government expenditures rise in view of an increase in the number of people entitled to employment benefits. At the same time, the decline in private consumption expenditures leads to lower VAT-revenues for the Treasury. This loss of revenue is aggravated by a decrease in income tax revenues as a result of a drop in employment and lower revenues from corporate taxation. Letting these automatic stabilisers work freely provides an impulse to the economy, but at the same time contributes to the increase in the government deficit, which is forecast to amount to 4.9% GDP in 2009 and further deteriorate to 6.1% GDP in 2010. These projections are in line with earlier expectations.

The oil price has declined rapidly since 2008. This is primarily reflected in lower fuel prices, which have a significant downward impact on inflation. Gas and electricity prices have declined considerably in the Netherlands since July 2009. The economic slump caused further downward pressure on the price level. As a result, inflation (CPI) remained subdued in 2009 at 1¼%. In 2010, private production is set to rise again, whilst employment will continue to fall. Unit labour costs will significantly decrease and the rise in the general price level is therefore forecast to remain limited to 1%, despite a gradual increase in oil prices.

**Table 3.3 Macroeconomic prospects**

	ESA Code	2008	2008	2009	2010	2011	2012
		Level (bln €)	rate of change	rate of change	rate of change	rate of change	rate of change
Real GDP	B1 *g	595.9	2.0	-4	1.5	2	2
Nominal GDP (€ bln)	B1 *g	595.9	4.8	-3¾	1½	3	3
<b>Components of real GDP</b>							
Private consumption expenditure	P.3	272.5	1.3	-2½	¼	1.5	1.5
Government expenditure	P.3	151.8	2.5	2¼	¾	¼	-½
Gross fixed capital formation	P.51	121.7	4.9	-11¾	-4	6	6
Changes in inventories (?)	P.52+ P.53	0.2	0.3	-½	1	0	0
Exports of goods and services	P.6	457.4	2.7	-8¾	4¾	6.5	6
Imports of goods and services	P.7	407.6	3.7	-9¼	3½	5	5
<b>Contributions to real GDP growth</b>							
Final domestic demand		546.1	2.1	-3	-¾	1¼	1¼
Changes in inventories (?)	P.52+ P.53	0.2	0.3	-½	1	0	0
External balance of goods and services	B.11	49.8	-0.4	-½	1¼	¾	¾

Source: For 2009 and 2010: all figures taken from or consistent with CPB Newsletter 2009/4; For 2011 and 2012: Ministry of Finance's own estimates

### **Medium-term scenario**

Prior to the crisis, potential growth for the period 2008-2011 was estimated to be 2% per year on average.<sup>4</sup> However, due to the crisis, this estimate can no longer be considered a realistic outcome. Building on experience of earlier financial crises, it is quite likely that part of the growth loss associated with the crisis can be considered to be structural and hence will have a negative impact on potential output.

There has not yet been a systematic analysis of the effect of the crisis on potential output in the Netherlands by the CPB. The CPB plans to publish an estimate for potential output over the period 2011-2015 in May 2010, as part of its new medium-term outlook. At the current juncture, it is extremely difficult to make assertions regarding potential growth and the output gap given the lack of clarity about the length and depth of the crisis. Therefore, any projections are

<sup>4</sup> Source: CPB document 151, "Actualisatie Economische Verkenning 2008-2011", September 2007

surrounded by large uncertainty. The output gap (EC method) is projected to be -3.2% in 2009 and -2.7% in 2010. The assumption in the extrapolations is that the output gap will close in 2015. This leads to an annual reduction of the output gap by 0.55% of GDP in the years 2011-2012.

**Table 3.4 Cyclical developments**

	2008	2009	2010	2011	2012
<b>Real GDP growth</b>	2.0	-4	1½	2	2
Potential GDP growth	1.9	1.4	1.0	1.5	1.5
<i>Contributions to growth:</i>					
- Labour	0.4	0.3	0.1	0.2	0.2
- Capital	0.8	0.4	0.3	0.4	0.4
- Total factor productivity	0.7	0.7	0.7	0.8	0.8
Output gap	2.3	-3.2	-2.7	-2.2	-1.6

Source: For 2009 and 2010: all figures taken from or consistent with CPB Newsletter 2009/4; For 2011 and 2012: Ministry of Finance's own estimates

### **Sectoral balances**

Contract wages in the market sector are expected to have risen by 3% in 2009, which is well above inflation. This is due to the fact that wage negotiations occur only every 2 years on average. As a consequence, and due to a drop in labour productivity, unit labour costs are expected to have risen by 5¼% in 2009. As a result, profit margins are under pressure. Production will increase again in 2010 by 2%, while the employment level is expected to drop sharply. The result will be strong productivity growth. In 2010, contract wage increases (including wage agreements from earlier years) are expected to remain limited to 1¼%, thus being more in line with inflation. Unit labour costs will decline significantly as a result by an expected 3¼%. Such a pronounced fluctuation from one year to the next is highly unusual.

Despite the relatively unfavourable development of the unit labour costs, the price competitiveness of the Netherlands is expected to have improved by 1.5% in 2009. This is primarily caused by a drop in profit margins. In 2010 price competitiveness will deteriorate by ¾%, as the prices of foreign competing products are expected to fall slightly more than the prices of Dutch exports. The tight labour market and the substantial current account surplus at the onset of the recession nonetheless indicate that the competitive position of the Netherlands is not at stake.

Despite the adverse development of price competitiveness in 2010, the trade balance is expected to remain highly positive. The public sector is expected to remain a net borrower over the next years.

**Table 3.5 Sectoral balances**

% of GDP	ESA Code	2008	2009	2010	2011	2012
<b>Net lending/borrowing vis-à-vis the rest of the world</b>	B.9	4.2	4½	5¾	6¼	6¼
<i>Of which</i>						
- Balance on goods and services		8.3	7½	7¾	8	8
- Balance of primary incomes and transfers		- 2.6	- 1½	- ¼	- ¼	- ¼
- Capital account		-1.5	- 1¼	- 1¾	-1½	-1½
<b>Net lending/borrowing of the private sector</b>		3.5	9¼	11¾	11¼	10¾
<b>Net lending/borrowing of general government*</b>		0.7	-4.9	-6.1	-5.0	-4.5
<b>Statistical discrepancy</b>		0.0	0.0	0.0	0.0	0.0

Source: For 2009 and 2010: all figures taken from or consistent with CPB Newsletter 2009/4; For 2011 and 2012: Ministry of Finance's own estimates

\* The figures for 2011 and 2012 are not to be interpreted as budgetary targets, but as technical outcomes based on a no-additional-policy scenario. The government will start considering further measures in June.

### **Labour market**

The Dutch labour market was performing well in 2008, as unemployment reached a low level of 3.9%. During the second half of 2008, the crisis started to have an impact on the labour market. The number of job openings started to drop rapidly from the third quarter of 2008 onwards. Unemployment increased steadily during the first half of 2009 and is expected to increase further. According to the latest projection of the CPB, unemployment reached 5% in 2009 and will increase further to 6½% in 2010.

In the private sector, the decline in years of employment is projected at 2¾% in 2009. In 2010, the decline is forecast to be more pronounced, at 3½%. On average, compared to 2008, in 2010 250,000 fewer people will be employed in the private sector.

The impact of the economic crisis on the labour market has been relatively modest so far. Unemployment forecasts, especially for 2010, have been significantly revised downward in the December projection of the CPB compared to its September forecast. An important reason for these downward revisions is the better than anticipated employment development. This is primarily the result of the improved economic outlook and the better than anticipated profitability of firms. The latter appears to be partly driven by a more flexible than expected labour market response to the crisis, via lower one-off remunerations, like bonuses and compensations for overtime, and fewer hours worked, particularly by the self-employed, which do not show up in the unemployment statistics.

Furthermore, the fact that the Dutch labour market was very tight at the beginning of the crisis turned out to be a relevant factor for the behaviour of employers. It made them relatively hesitant to lay off employees, instead looking for alternative responses and making use of the partial unemployment scheme offered by the government. A final reason for the downward revision of unemployment forecasts is the stronger than expected discouraged worker effect. For example, a lot of young people have postponed their entry into the labour market and decided to continue studying. As a result, estimates of the labour supply have been revised downward.

**Table 3.6 Labour market developments**

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
Employment (x thousand persons)		8734	2.4	- ¼	- 1½	½	½
Employment (bln hours worked)		12.1	1.2	- 1½	- 2¼	½	½
Unemployment rate (% of labour force)		304 (x thousand persons)	3.9	5	6½	6½	6½
Labour productivity (persons)		60.2	2.4	- 3½	3¼	1½	1½
Labour productivity, hours worked		44.0	3.6	- 2¼	3¼	1½	1½
Compensation of employees	D.1	295.1	5.2	1¾	- ¼	2½	2½
Compensation per employee		49.2	3.8	2¾	2¼	2	2

Source: For 2009 and 2010: all figures taken from or consistent with CPB Newsletter 2009/4; For 2011 and 2012: Ministry of Finance's own estimates

### **Comparison with Autumn Forecast**

As can be seen in table 3.7, the budgetary and macroeconomic forecasts of the Dutch government and of the European Commission for the period 2007-2009 are roughly identical. Both forecast a sharp deterioration of economic activity in 2009 and virtually the same development of the general government balance. However, with regards to the period 2010, the forecast by the CPB is markedly more positive than the Commission's Autumn Forecasts. This may be largely due to the fact that it was published more than a month later and therefore incorporates more recent information and realisations, notably with respect to the third quarter of 2009. As prospects for both the global and Dutch economy have continued to improve, this is reflected in a more positive macroeconomic outlook.

**Table 3.7 Comparison with Autumn Forecasts**

<b>Variable</b>	<b>Source</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011<sup>5</sup></b>
Economic growth	EC	3.6	2.0	-4.5	0.3	1.6
	NL/CPB	3.6	2.0	-4.0	1.5	2
Private consumption	EC	1.7	1.3	-2.7	-0.6	0.6
	NL/CPB	1.7	1.3	-2.5	0.25	1.5
Gross fixed capital formation	EC	4.8	4.9	-11.7	-6.0	0.4
	NL/CPB	4.9	4.9	-11.75	-4	6
General government balance	EC	0.2	0.7	-4.7	-6.1	-5.6
	NL	0.2	0.7	-4.9	-6.1	-5.0

<sup>5</sup> The figures provided by the Netherlands are based on technical projections by the Ministry of Finance.



## Chapter 4 General government balance and debt

*Recent economic and financial events have had a profound impact on government finances. The budget deficit is forecast at 4.9% of GDP in 2009 and 6.1% of GDP in 2010. A scenario of 2% growth including the already adopted measures leads to a budget balance of -5.0% in 2011 and -4.5% of GDP in 2012. Due to interventions in the financial sector and the deterioration of the budget balance, the debt level has risen sharply.*

### **Introduction**

This chapter gives an overview of the development of the budget balance and government debt for the period up to and including 2012. This chapter first outlines the government's policy strategy and its relation to the Medium-term Objective. It then gives a quantitative overview of the developments in the government balance, paying attention to the structural and cyclical effects. Finally an outlook for the development in government debt is shown.

The data for 2009 and 2010 in this chapter are based on the most recent outlook, the December Report of the CPB, and extrapolations for the years following 2010, because estimates on these years are not yet available. The CPB will publish its first forecast for 2011 in March 2010, while in its medium-term forecasts in May the CPB will provide more insight in the structural impact of the crisis on the Dutch economy. In our baseline for 2011-2012, GDP-growth is set at 2% per year, based on **technical assumptions, on the basis of a no-policy-change scenario**. Chapter 3 gave an overview of the underlying macroeconomic assumptions. Because of the large uncertainty caused by the economic crisis and the continuing uncertainty regarding economic recovery, forecasts about the development of public finances are also very uncertain. The numbers presented below should be put in that perspective.

### **Development EMU balance since previous update**

Recent economic and financial events have had a profound impact on government finance. The suddenness with which this happened can be illustrated by comparing the forecasts for the budget deficit in the last update of the Stability Programme with the current update. According to projections by the Ministry of Finance based on the most recent CPB economic outlook dating from December, a budget deficit of 4.9% of GDP is expected for 2009 and of 6.1% of GDP for 2010. Compared to the projections in the previous update of the Stability Programme, the EMU balance has deteriorated by more than 6%-points of GDP in both years (see table 4.1). This is largely due to the effects of the automatic stabilisers; tax

revenues and social security contributions have decreased considerably, while expenditures on unemployment benefits and interest have increased. Added to this is the implementation of an extensive stimulus package to counter the effects of the economic downturn as well as lower-than-anticipated gas receipts. All together the economic downturn has left deep marks on the budget balance.

**Table 4.1 Development EMU balance in % GDP**

	2009	2010
<b>EMU balance Stability Programme November 2008</b>	<b>1.2%</b>	<b>0.8%</b>
Tax revenues and social security contributions	-4.4%	-5.3%
Gas revenues	-1.0%	-0.7%
Expenditures on unemployment	-0.3%	-0.8%
Stimulus package	-0.4%	-0.5%
Interest payments	-0.2%	-0.2%
Revenues interventions in financial sector	0.3%	0.1%
EMU balance local governments	-0.6%	-0.7%
Other expenditures	0.5%	1.2%
<b>EMU balance Stability Programme January 2010</b>	<b>-4.9%</b>	<b>-6.1%</b>

**Box 4.1: Tax elasticity**

The tax elasticity measures the endogenous growth in tax revenues (including social premia) following a 1% change in GDP-growth. It is generally assumed that over a long period tax revenue growth more or less follows economic growth. In the short run, tax elasticity can fluctuate significantly. In periods of low economic activity the tax elasticity is generally lower than one. In times of high economic activity the opposite will generally be the case. Indeed in 2006 and 2007, years of high economic activity, the tax elasticity turned out > 1. In 2008, a year still marked by positive growth, the tax elasticity turned out < 1. For 2009, a year of negative growth, we expect tax revenue growth to be even more negative than GDP-growth. In 2010, endogenous tax revenue growth is expected to be positive again but it will still lag behind the (positive) economic growth. The implicit tax elasticity for 2010 is expected to be about 0.7. With regard to the estimated tax revenues in the period 2011-2012 it is assumed that tax revenues more or less follows GDP-growth.

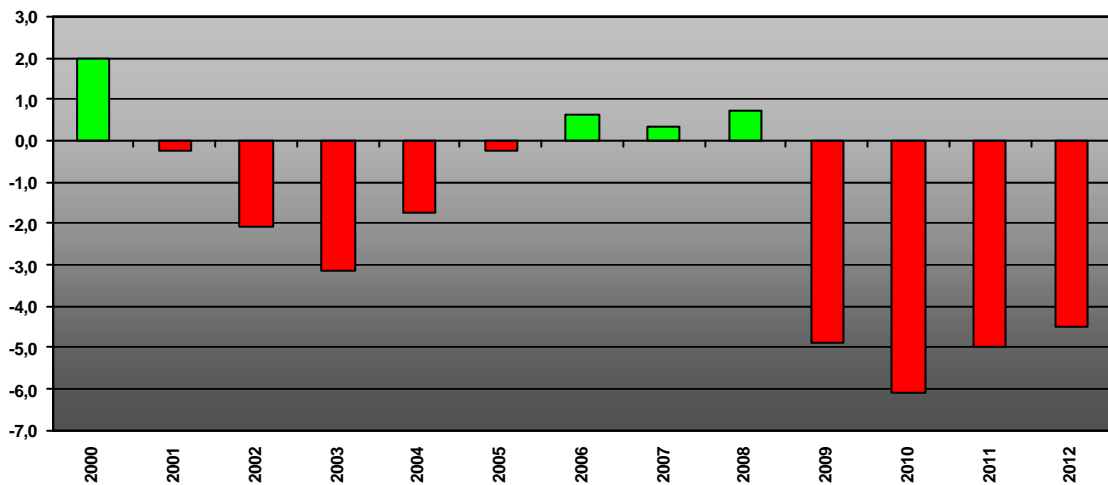
The budgetary targets of this government were based on the MTO at the time: a structural deficit ranging from 1% to 0.5% of GDP. Yet, it was recognised that this MTO would not be sufficient to ensure long-term sustainability of public finance in light of the costs of ageing. Therefore, the government originally set a target for a structural surplus of 1% of GDP in 2011. Because of the enormous impact of the crisis on the economy, the worldwide consensus on the need to stimulate the

economy, and the enhanced effect of automatic stabilisation by the stimulus package (in particular extra expenditures on unemployment benefits), the original target for the structural balance is currently out of reach. Therefore, the government has presented its supplementary policy agreement 'Working on the Future' and its three pillar strategy as described in Chapter 1.

**Actual budget balance**

Table 4.2 and Figure 4.1 both show the projections of the actual budget balance and the outlook of the general government balance for the coming years using the economic assumptions of the recent CPB forecasts for 2009-2010 and extrapolations for 2011-2012. The figures include all policy measures up to the Budget Memorandum for 2010. Beyond that, the developments are based on a no policy change scenario, i.e. the government's commitment to the necessary consolidation in the context of the Excessive Deficit Procedure is not yet incorporated in this prognosis.

**Figure 4.1 General government balance and outlook for the coming years in % of GDP (no policy change scenario)**



In the projected period, the EMU deficit will reach its maximum level in 2010, gradually improving thereafter to a deficit of 4.5% of GDP in 2012. In 2010 the growth in tax revenues lags behind economic growth due to, among other things, a higher unemployment level which causes a slight decline in personal income tax. For 2011-2012 the assumption is that tax revenues increase more or less proportionally with (nominal) economic growth (see box 4.1). Furthermore, the government balance receives an extra boost in 2011 because of the expiration of the stimulus package. The deficit of the local governments declines every year, whereas the gas receipts increase every year, both in line with the economic recovery.

The budget memorandum 2010 reports higher expenditures on social security, infrastructure, housing and environmental protection (see table 4.2). This is the effect of increasing expenditures on unemployment benefits and the measures of the stimulus package (see table 6.1 for an overview of all stimulus measures). All other extra expenditures are solved within the expenditure ceilings. In 2011 the increases in the above mentioned categories are cancelled out by the expiration of the stimulus package (4.4 bln). Also the consolidation measures of the supplementary policy agreement are implemented, which leads to lower expenditures of 1.8 bln (see overview in box 2.3) in public service and other expenditures (see table 4.2). Almost all other expenditures increase every year in nominal terms because of inflation, the ageing population (old age benefits and health care), and planned investments in infrastructure in the period 2010-2015. The expected deficits also lead to increasing expenditures on interest. Taken together this leads to a projection for the EMU balance that improves year-on-year in both 2011 and 2012. As mentioned in chapters 1 and 2, the government is committed to take additional policy measures to reach the 3% government deficit reference value by 2013 and has put in place a strategy to achieve a durable return to sound public finances (of which the correction of the excessive deficit will only be a first step).

**Table 4.2: EMU balance 2007-2012**

<b>In % of GDP</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Total revenue</b>	<b>44.6</b>	<b>45.6</b>	<b>44.4</b>	<b>44.3</b>	<b>44.9</b>	<b>45.5</b>
Total taxes	24.8	24.1	24.2	23.4	23.6	23.9
Social contributions	14.3	15.2	14.2	15.2	15.6	15.7
Property income	2.6	3.4	2.9	2.5	2.5	2.7
Other revenues	2.9	2.9	3.1	3.2	3.2	3.2
<b>Total expenditure</b>	<b>44.4</b>	<b>44.9</b>	<b>49.3</b>	<b>50.4</b>	<b>49.9</b>	<b>50.0</b>
Public health	8.8	8.7	9.6	9.8	10.0	10.2
Social security	10.8	11.1	12.3	12.7	12.2	11.8
Public service	10.4	10.6	11.4	11.3	10.9	10.8
Education	5.1	5.0	5.4	5.5	5.5	5.5
Interest payments	2.2	2.1	2.4	2.4	2.4	2.5
Other expenditures	7.1	7.4	8.2	8.7	8.9	9.1
<b>EMU balance*</b>	<b>0.2</b>	<b>0.7</b>	<b>-4.9</b>	<b>-6.1</b>	<b>-5.0</b>	<b>-4.5</b>

\* The figures for 2011 and 2012 are not to be interpreted as budgetary targets, but as technical outcomes based on a no-additional-policy scenario. The government will start considering further measures in June.

#### **Structural budget balance**

Table 4.3 provides a comprehensive overview of the determinants of the structural balance, considering the macroeconomic assumptions as presented in

Chapter 3. The previously mentioned uncertainty regarding the data is especially relevant when separating the cyclical and structural components of the government balance.

For 2009 a structural deficit of 3.5% of GDP is expected to be recorded. This is smaller than the actual EMU deficit. This indicates that the Dutch economy has clearly operated below its potential level, resulting in a negative output gap and therefore a negative cyclical adjustment. The output gap for 2010 is estimated to be -2.7% (EC method). The assumption in the extrapolations is that the output gap will close in 2015. This leads to an annual reduction of the output gap by 0.55% of GDP in the years 2011-2012.

Because the actual growth projection for the years 2010-2012 exceeds the potential growth projection, the cyclical adjustment becomes smaller every year. Therefore, the difference between the structural balance and the actual balance diminishes over time. However, these projections are to be taken with great caution, as in current economic it is extremely difficult to make accurate projections for the output gap and because projections are based on technical assumptions for the years 2011-2012.

**Table 4.3: Actual and structural budget balance**

(% of GDP)	2008	2009	2010	2011	2012
1. Actual balance*	0.7	-4.9	-6.1	-5.0	-4.5
2. Cyclical adjustment	1.3	-1.8	-1.5	-1.2	-0.9
3. Special items					
<i>of which: Refund discount EU contribution</i>	-0.2	0.4			
4. Structural balance (1-2-3)*	-0.4	-3.5	-4.7	-3.8	-3.6
Output gap	2.3	-3.2	-2.7	-2.2	-1.6

\* The figures for 2011 and 2012 are not to be interpreted as budgetary targets, but as technical outcomes based on a no-additional-policy scenario. The government will start considering further measures in June.

### **Government debt**

A little over a year ago, in the Budget Memorandum 2009, the government debt was expected to reach an all-time low of 36% of GDP in 2011. The crisis changed the outlook dramatically. Due to interventions in the financial sector (amounting to approximately 13.9% of GDP, see box 4.2) and the deterioration of the budget balance, debt levels have risen sharply. Because of the expected deficits for the period 2010-2012, government debt will continue to grow. However, part of the build-up of additional debt is matched by financial assets. In the estimates for government debt, no policy change is assumed for the interventions in the

financial market, because it is very difficult to make projections about when these will be reversed. In our medium-term forecast interest payments and dividends related to these interventions are therefore taken into account.

**Box 4.2: Budgetary consequences of interventions in financial markets**

Since Autumn of 2008 the Dutch government has undertaken several interventions in order to support the Dutch financial system and to help restore stability in the financial world. These interventions influence the budget balance, the gross debt ratio or both. This box gives a brief overview of the transactions and their consequences for the gross debt ratio and budget balance. The budgetary implications of these transactions can be found in the table below. In general, there are three types of transactions: direct financial transactions, interest payments and dividends, and guarantee schemes. Direct financial transactions are not relevant for the budget balance, but are relevant for the gross debt ratio. Interest revenues, payments, and dividends arising from the financial transactions are relevant for both the budget balance and the gross debt ratio. Possible payments arising from guarantee schemes will also be relevant for both the balance and debt ratio.

In the Spring of 2009 ING, Aegon and SNS Reaal announced their intention to make use of the option to make an advanced repurchase of securities. These institutions will pay the principal and the coupon interest (8,5% per year), but will also pay a premium for the advanced repurchase. The size of this premium depends on the market quotation of ordinary shares. Total repayments amount to €5606 mln for ING, €1152 mln for Aegon and €192 mln for SNS Reaal.

Fortis paid off about €35 bln of its bridging loan in 2009. The total amount of the bridging loan issued to Fortis was €44 bln. As a consequence of this repayment, gross debt ratio falls. Furthermore, by the end of 2009 an additional amount of €1.35 bln in loans was converted into unquoted Fortis shares as part of the Fortis/ABN Amro recapitalisation. This operation also entailed an additional capital injection to ABN Amro for an amount of €1.8 bln in the form of convertible securities. This recapitalisation was required to compensate for the loss of core capital due to the sale of IFN Finance and NEW HBU below book value (as part of the EC remedy) and to cover costs of future integration.

Regarding the back-up facility, ING agreed in October to an additional payment deal as part of a restructuring plan. During the entire term of the facility, ING will pay a higher guarantee fee (0.8 percentage point) and will receive a lower funding (0.5 percentage point). The net present value of this additional agreement is

approximately €1.3 bln and the agreement increases the chance of a positive return.

Finally, a total amount of €200 bln of debt guarantees was envisaged, if necessary. Of this amount €47.2 bln has been effectively guaranteed. While the remaining amount is in principle available until 30 June 2010, the amount of guaranteed debt has been declining since August 2009 (by €3.1 bln).

**Budgetary consequences of interventions in the financial sector**

(in € mln) *	2008	2009	2010
<b>A. Acquisition of Fortis Bank / RFS Holdings / ABN Amro</b>			
1. Participation in Fortis	16.800	1.350	
2. Participation in RFS / ABN Amro	6.540	-	
3. Sale of Fortis Corporate Insurance (FCI)		-350	
4. Bridging loan to Fortis	44.341	-	
5. Interest receipts on bridging loan	-502	-600	-200
6. Redemption of bridging loan		-36.516	-3.250
7. Dividend Fortis	0	0	0
8. Dividend RFS/AA	0	0	0
<b>B. Capital strengthening facility (€20 bn.)</b>			
9. Capital furnished to ING, Aegon, SNS Reaal	13.750		
10. Interest receipts on securities		-578	
11. Redeemed securities ING (including accrued interest and minimum repurchase fee)		-5.514	-91
12. Redeemed securities Aegon (including accrued interest and repurchase fee)		1.129	23
13. Redeemed securities SNS Reaal (including accrued interest)			-191 -1
<b>C. Back-up facility ING</b>			
14. Obligation to ING (no cash flow)		16.813	
15. Funding fee		3.846	2.953
16. Management fee		54	46
17. Principal received		-3.761	-3.127
18. Guarantee fee		-118	-101
19. Additional guarantee fee following E.C. decision		0	
20. Additional interest received following E.C. decision		-21	
21. Net cash flow to State (sum 15/20)		0	
<b>D. State guarantee facility on interbank loans (€200 bn.)</b>			
22. Issued guarantees	2.740	45.585	
23. Received fees	0	-115	-386
<b>E. Iceland</b>			
24. Prefinancing of payments from Icesave, deposit-guarantee scheme	1.236	192	0
<b>F. Capital Relief Instrument ABN-AMRO (CRI)</b>			
25. Guaranteed value		32.822	-2.719
26. Received fees		-28	-165
<b>G. Mandatory Convertible Notes ABN-AMRO (MCN)</b>			
27. Issued loan		800	

28. Interest receipts		0	-80
<b>H. Security ABN-AMRO</b>			
29. Issued loan		1.800	
<b>I. Other items</b>			
30. Costs of implementation and outside staff	11	45	
* Rounding errors possible.			

In the baseline scenario government debt will rise from 62% of GDP in 2009 to 73% of GDP in 2012. When debt is revised for the interventions in the financial sector since October 2008, debt would reach 51% of GDP in 2009 and 63% of GDP in 2012. For the development in general government debt, see Table 4.4.

**Table 4.4 General government debt development**

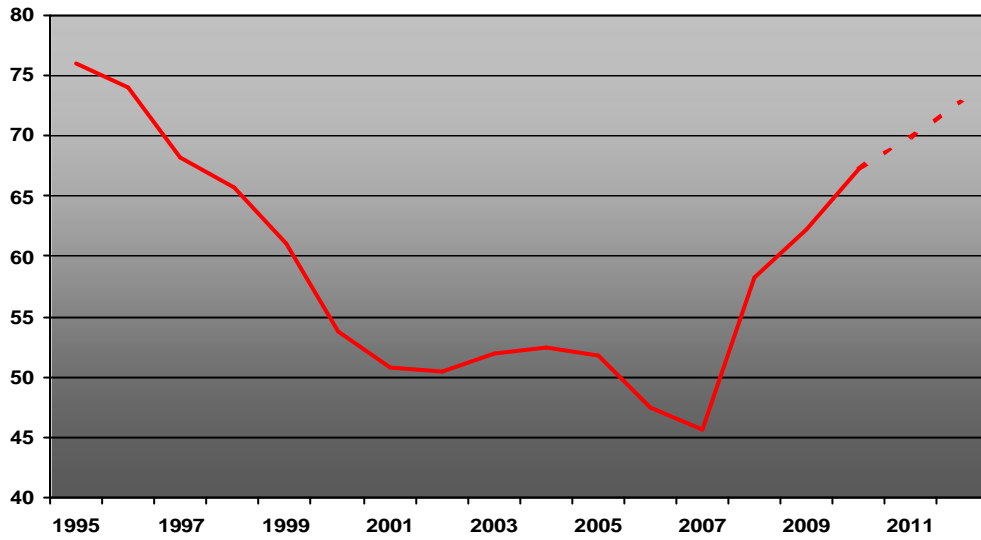
	2008	2009	2010	2011	2012
1. Gross debt*	58%	62%	67%	70%	73%
2. Change in gross debt ratio*	13%	4%	5%	2%	3%
<b>Contributions to changes in gross debt</b>					
3. Primary balance ("-" = surplus)	-2.8%	2.5%	3.7%	2.6%	2.0%
4. Interest expenditure	2.1%	2.4%	2.4%	2.4%	2.5%
5. Stock-flow adjustment	13.4%	-0.8%	-1.1%	-2.7%	-1.6%
(of which denominator effect)	-2.1%	2.2%	-0.9%	-2.0%	-2.0%

\* rounded in whole percentages

Figure 4.2 shows the development of the government debt and the outlook for the coming years.



**Figure 4.2 General government debt and outlook for the coming years in % of GDP (no policy change scenario)**



This chapter has given a quantitative picture of the development in government finances for the coming years. As mentioned, this is done under many uncertainties concerning the underlying variables. The next chapter addresses this uncertainty in two different sensitivity analyses.

## Chapter 5 Sensitivity analysis and comparison with previous update

Compared to the previous update, economic growth in 2009 turned out much lower than foreseen, with smaller differences for 2010 and 2011. This chapter shows how GDP volume and the budget balance improve more rapidly in an alternative scenario of improved world trade and higher import prices, and how these variables are negatively affected in an alternative scenario of lower growth of world trade and a depreciation of the euro.

### Comparison with previous update

Compared to the previous update, real growth figures for the year 2008 show a small decline. The same holds for the year 2010. However, the financial crisis had a deep impact on real GDP growth in 2009, which was not yet foreseen at the time of last year's update which was based on projections dating from September 2008. The year 2009 shows a contraction of 4% of GDP. Compared to the last update, this implies a difference of 5.25 percentage points. For the years 2011 and onwards, real GDP shows a projected 2% growth a year, which is slightly higher compared to the previous update.

Table 5.1 presents the differences as compared to the previous Stability Programme<sup>6</sup>.

**Table 5.1 Divergence from previous update**

	ESA Code	2008	2009	2010	2011	2012
<b>Real GDP growth (%)</b>						
Previous update		2.25	1.25	1.75	1.75	NA
Current update		2.0	-4.0	1.5	2.0	2.0
Difference		-0.25	-5.25	-0.25	0.25	NA
<b>General government net lending (% of GDP)</b>						
	EDP B.9					
Previous update		1.2	1.2	0.8	1.1	NA
Current update		0.7	-4.9	-6.1	-5.0	-4.5
Difference		-0.5	-6.1	-6.9	-6.1	NA
<b>General government gross debt (% of GDP)</b>						
Previous update		42.1	39.6	38.0	36.2	NA
Current update		58.2	62.2	67.4	69.6	72.5
Difference		16.1	22.6	29.4	33.4	NA

<sup>6</sup> For the sake of clarity it must be noted that in this case reference is made towards the regular Stability Programme Update, dating November 2008, and not the Addendum published in December.

In 2008, net government lending is slightly lower compared to the previous update. The year 2009 shows a budget balance of -4.9% of GDP. The automatic stabilisation and the stimulus measures are the main reasons for the negative budget balance in the year 2009. Although growth figures for the year 2010 are positive, the impact of the crisis is still very distinct. From 2011 onwards the budget balance displays a steady improvement, thereby reducing the difference with the previous update.

In the years 2008 and 2009 the Dutch government intervened in the financial market, so as to secure financial stability. The transactions had a big impact on the Dutch general government gross debt and largely explain the deterioration of the general government gross debt ratio in 2008. For the years 2009 and onwards, the increase in the debt ratio is primarily the result of the budget deficits.

### ***Alternative scenarios and risks including sensitivity of budgetary projections***

In chapter 3 the economic outlook was presented. As stated, a great degree of uncertainty surrounds the baseline scenario, mainly resulting from risks with respect to the timing, the degree, and the pace of the recovery. The Netherlands, being a small open economy, is particularly sensitive to global developments. Therefore, this sensitivity analysis will present possible effects of alternative developments in one of the most influential external assumptions for Dutch economic performance, namely relevant world trade. As such, two scenarios will be presented, accounting for both upward and downward risks. The first scenario mimics an improved development of world trade and, as a consequence, higher import prices. The second scenario displays a sudden decrease in world trade and a depreciation of the euro. Effects will be shown on major macroeconomic variables for 2010.

#### *Scenario 1: Improved world trade, higher import prices*

The recovery of the global economy could be stronger in the short-term as a result of a quicker restoration of consumer and producer confidence. This would entail less saving by consumers and a faster build-up of inventories by the corporate sector. This would lead to a higher growth rate of world trade and a steeper price development of oil and raw materials in early 2010. During the course of 2010, however, the growth of world trade would fall back to its development as projected in the baseline scenario, under the assumption that the pickup in consumer confidence is of a temporary nature and as such is insufficient for a fundamental recovery of supply and demand.

The advantageous external development allows Dutch producers to increase their exports. The resulting extra production and higher degree of capacity utilization induces investment and has a positive effect on employment in 2010. The higher imported inflation has a dampening effect on consumption. Wages lag behind this additional inflation, as for most employees collective labour agreements for 2010 have already been signed. In the short-term, this effect dominates the upward effect on consumption of higher employment. On balance, therefore, private consumption will be lower than in the baseline scenario. Compared to the baseline scenario, in 2010 GDP volume increases by 1.1%, while the budget balance improves by 0.5 percentage point in 2010.

**Table 5.2 Alternative scenario 1, comparison with baseline scenario (deviations in %)**

	Baseline scenario 2010	2010
Volume of relevant world trade	7½	5.0
Long-term interest rate	3¾	1.0
Oil price	77	15.0
Wage rate private sector	1¼	0.9
Consumer price index (CPI)	1	1.0
Volume of GDP	1½	1.1
Volume of private consumption	¼	-0.8
Volume of private investment (excluding residential investment)	-7¼	1.1
Volume of exports of goods (excluding energy)	6	4.4
Employment	-1½	0.5
General government balance (% of GDP)	-6.1	0.5

*Scenario 2: Lower world trade, depreciation of the euro*

The fragile recovery of the global economy could be disrupted by a number of factors, for example by renewed problems in the financial sector. This could lead to a lower growth of world trade and a weaker euro. In this scenario, the modest recovery of exports disappears. Lower degrees of capacity utilization and profitability lower the propensity to invest. On top of this, employment will come under extra pressure, which, together with higher inflation, leads to lower consumption. In this scenario, GDP growth will fall by 0.9 percentage point compared to the baseline scenario. Moreover, the lower production leads to rising

unemployment. As a result of lower tax revenues and additional expenditures on social benefits, the budget balance deteriorates by 0.3 percentage point compared to the baseline scenario in 2010.

**Table 5.3 Alternative scenario 2, comparison with baseline scenario (deviations in %)**

	Baseline scenario 2010	2010
Volume of relevant world trade	7½	-3.0
Long-term interest rate	3¾	0.3
Oil price	77	0.0
Wage rate private sector	1¼	-0.3
Consumer price index (CPI)	1	0.3
Volume of GDP	1½	-0.9
Volume of private consumption	¼	-0.7
Volume of private investment (excluding residential investment)	-7¼	-2.9
Volume of exports of goods (excluding energy)	6	-1.9
Employment	-1½	-0.3
General government balance (% of GDP)	-6.1	-0.3

## Chapter 6 Quality of public finances

For 2009 and 2010, the government has designed measures that are supportive to growth and that make the economy more innovative and greener. Moreover, the Fundamental Budget Review and the preliminary study for revision of the tax system will help to ensure sound public finances. A priority of the government is also to reduce the administrative burden and to increase the labour market participation.

### *Developments on the expenditure side*

The government adopted a total of three recovery packages. The stimulus measures were aimed at areas that were most affected by the crisis, focusing on household purchasing power, private (and public) investment and employment protection. Moreover, the measures were designed in such a way that they enhance sustainable growth, support innovation and increase labour market participation. Specifically, the packages include measures aimed at a sustainable energy system, innovation and knowledge, urban renewal and developing districts. Table 6.1 provides an overview of the stimulus measures adopted by the government.

**Table 6.1 Government's stimulus measures<sup>7</sup>**

<b>+ = Intensification in € bln (on cash basis)</b>	<b>2009</b>	<b>2010</b>
<b>a. Labour market, education, and knowledge sector</b>	<b>0.64</b>	<b>0.94</b>
Investment in Insurance Supervision Act (WTV) and part-time Unemployment Act (WW) (partly November Package)	0.23	0.20
Investment in addressing youth unemployment	0.08	0.12
Investment in strengthening upper secondary vocational education (MBO)	0.10	0.17
Investment in strengthening knowledge infrastructure; temporary use of knowledge workers	0.09	0.19
Investment in implementing Fund for Economic Structural Reinforcement (FES) innovation projects	0.11	0.11
Investment in continuation Fund for Economic Structural Reinforcement (FES) innovation projects	0.00	0.10
Debt assistance	0.03	0.05
<b>b. Sustainable economy</b>	<b>0.29</b>	<b>0.63</b>
Wrecking agreement cars	0.03	0.03
Energy saving measures for housing	0.01	0.02
Sustainable energy (SDE)	0.00	0.02

<sup>7</sup> This table provides a comprehensive overview of all stimulus measures: The November Package, the January Package, and the stimulus measures in the Supplemental Policy Agreement are included (2.2 bln for 2009 and 3.4 bln for 2010).

Investment in rapid implementation of FES Environment and Sustainability projects	0.09	0.13
Investment in implementing Van Geel Motion spatial economy	0.06	0.06
Investment in rapid implementation of FES Spatial Economy Policy	0.09	0.29
Investment in sustainable agricultural sector	0.00	0.04
Electrical car	0.00	0.02
Sustainable entrepreneurship	0.00	0.03
<b>c. Infrastructure and (housing) construction</b>	<b>0.59</b>	<b>1.18</b>
Investment in delta programmes (incl. Sand Replenishment)	0.08	0.05
Investment in rapid implementation of FES Infrastructure projects	0.07	0.20
Investment in accelerating bridges and renovating roads	0.08	0.14
Investment in waterways, locks, and inland harbors	0.08	0.13
Investment in youth care organizations	0.03	0.06
Investment in care and long-term care organizations	0.00	0.32
Investment in schools	0.00	0.17
Investment in rapid implementation BLS and monuments	0.26	0.13
<b>d. Extension of liquidity for business and industry</b>	<b>1.20</b>	<b>1.37</b>
Investment in November package (incl. Foreign Workers Employment Act (WAV))	0.50	0.80
Investment in easing the offset of losses for 2008	0.34	-0.12
Investment in extending reduction in Promotion of Research and Development Act (WBSO) contributions	0.14	0.15
Investment in medium-size and small business (MKB) envelope	0.00	0.05
Investment in Schiphol/aviation/ticket tax	0.07	0.28
Investment in Random Depreciation of Environmental Investments/Environmental Investment Allowance (VAMIL/MIA)	0.02	0.03
Lower VAT-tariff for isolation	0.01	0.03
Investment in Energy Investment Deduction (EIA)	0.12	0.15
<b>f. Realisation of FES projects</b>	<b>0.08</b>	<b>0.13</b>
<b>Total</b>	<b>2.80</b>	<b>4.25</b>

Table 6.2 presents an overview of developments in categories of government expenditures. While expenditures on defence and public services are projected to decrease in the coming years, expenditures on infrastructure, social security and education will increase. Expenditures on health care are expected to increase by almost 4% in real terms.

**Table 6.2 Developments in categories of government expenditures**

	2008	2012	2008-2012
	% of GDP	% of GDP	Real annual growth
Public service	10.6	10.8	-½
Safety	1.7	1.8	½
Defence	1.1	1.2	¼
Infrastructure	1.7	2.1	2½
Education	5.0	5.5	1¾
Publicly financed health	8.7	10.2	3¾
Social security	11.1	11.8	1
Transfers to companies	1.6	1.7	1½
International cooperation	2.3	2.3	¼

**Fundamental Budget Review**

The Fundamental Budget Review (FBR) will lay the foundation for sustainable public finances in the long-term. It will deal with structural reform options and will ensure a rapid restoration of a sound budgetary position in the coming years. With regard to the tax burden of social assistance premia and contributions, a separate study will be conducted on the structure of the tax system (see box 6.2).

**Box 6.1: The Fundamental Budget Review**

The Fundamental Budget Review was launched to provide the foundation for the political decision making process regarding a durable return to healthy and sustainable public finances.

History teaches us that it will take several years to recover from the damage that the crisis has brought about. The considerable effort required comes on top of existing fundamental challenges, such as a global shortage of energy and raw materials, climate change, the ongoing transition towards a knowledge based economy and the rise of new economic superpowers. This calls for clear and fundamental choices. The Fundamental Budget Review will provide the main input for these important choices.

The Fundamental Budget Review will cover a broad spectrum of policy fields (see the list presented below) and will produce concrete policy proposals for the future. The aim is to facilitate the making of substantial decisions by providing insight into structural reform and savings options and their possible consequences, without passing judgement on the relative desirability of these options. 20 groups of high-level civil servants and external experts are currently carrying out this extensive and comprehensive exercise. The FBR is intended to lead to a wide range of reform options, which are then to be presented to the government, allowing them to make choices. This budgetary review operation is fundamental in nature. To ensure a fundamental approach, at least one mandatory scenario has to be



developed for each policy area that sets out a structural 20% reduction in net spending (including tax expenditures) in 2010. Taken together, these 20% reduction scenarios will allow for a potential saving of €30-40 bln.

The operation was launched in October 2009 and will be completed by May 1<sup>st</sup> 2010. This creates room to incorporate the findings into the preparations for the 2011 Budget Memorandum where possible. It has been agreed that efforts to restore sound public finances will start in 2011, conditional on economic recovery. However, the approach of the Fundamental Budget Review goes further than medium-term fiscal consolidation; it deals with structural reform options which will benefit the long-term sustainability of public finances.

**Overview of 20 working groups with respective policy fields**

1) <i>Energy and climate</i>	11) <i>Acute care</i>
2) <i>Environment and nature</i>	12) <i>Long-term care</i>
3) <i>Mobility and water</i>	13) <i>International cooperation</i>
4) <i>Housing</i>	14) <i>Asylum, immigration and integration</i>
5) <i>Child policies</i>	15) <i>Safety and terrorism</i>
6) <i>Productivity of education</i>	16) <i>Execution of tax and premium levying</i>
7) <i>Tertiary education</i>	17) <i>Allowances</i>
8) <i>Innovation and applied research</i>	18) <i>Public administration</i>
9) <i>At a distance from the labour market</i>	19) <i>Management (including independent government agencies)</i>
10) <i>Unemployment</i>	20) <i>International security</i>

**Developments on the revenue side**

In addition to the Fundamental Budget Review, a separate study will take place with regard to the tax burden of social assistance premia and contributions. The aim of this study is to establish a system that will generate stable tax revenues in the future with minimal disruption of the economy and the fairest possible distribution of the costs. Box 6.2 will present the study in greater detail.

**Box 6.2: Preliminary study for revision of the tax system**

In order to complement the Fundamental Budget Review, which is primarily focused on the expenditure side, the government has decided to launch a preliminary study for the revision of the tax system.

There are a number of reasons for this study. First, recent developments on financial markets and the projected slowdown in real GDP growth have highlighted the importance of an improved assessment of variations in tax revenues (see chapter 4). Furthermore, it is important to analyse whether the current tax base (on labour, profit, consumption, housing, polluting behaviour, etc.) is sustainable in the future. Variations in the composition of the final tax base portfolio generate different economic effects. In addition, it is also relevant to determine whether a (further) simplification of different taxes can be achieved.

Taken together, these issues imply that the analysis will have to focus on the solidity, the solidarity, the economic efficiency, the simplicity and the environmental-friendliness of the Dutch tax system. In the UK, a similar analysis resulted in the so-called Mirrlees review. The government is sympathetic towards a similar review for the Netherlands, but struggles with the amount of time that is involved to complete this exercise. In this context, the revision of the tax system is to be treated as a preliminary study for a broader subsequent analysis.

The preliminary study will be performed by the 'Study Commission on the tax system', which was established by the Minister of Finance. The Study Commission is led by an external chairman and consists of external experts, civil servants, and the CPB. The study will be completed in the second quarter of 2010 and the results will be presented to the government and parliament in June 2010, together with the findings from the Budgeting Framework Commission.

***Economic implications of major structural reforms******Labour participation***

In the recent past, major structural reforms have improved both the growth capacity of the Dutch economy as well as the state of public finances. In line with the Lisbon agenda, the key aim of the labour market policy of the government is to increase labour market participation in view of the ageing workforce. The government aims to achieve a labour market participation (as defined by the CPB) of 80% in 2016 and has included measures for improving labour market participation in the coalition agreement.

The crisis packages contain measures for the labour market (e.g. part-time unemployment benefits, retraining bonus, Prior Learning Assessment and Recognition (PLAR), mobility centres) and focus on preventing the loss of skills and improving the alignment of supply and demand in the labour market. In total, the government has earmarked over € 1.6 bln for the period 2009-2011 for labour market related topics.

Various fiscal instruments intended to increase labour participation entered into force on 1 January 2009. These instruments increase the financial incentives to work (e.g. a bonus for older workers who continue to work over the age of 61, an earned income tax credit, an income-based supplementary combination tax credit, a phase out of the transferability of the general tax credit). In the supplementary policy agreement, the government announced its intention to increase the statutory retirement age from 65 to 67. Not only is this an important step towards more solid public finances, it also increases the labour supply of older workers.

The government has taken various measures to stimulate the labour supply among vulnerable groups, in line with the country specific recommendation to the Netherlands in the context of the Lisbon strategy. The Investment in the Young Act (WIJ) has been introduced with the aim of promoting sustainable participation by young people. The WIJ requires municipalities to provide either a job or study and training possibilities to jobless people up to the age of 27 who request unemployment benefits. A new Insurance Act for young disabled persons (Wajong) has entered into force as per 1 January 2010 with the aim to support young handicapped people on the labour market. Table 6.4 gives an overview of the most important measures that have been taken.

**Table 6.3 Policy response to the recommendation on improving the number of hours worked**

<b>Policy response</b>	<b>Entry into force</b>
<i>General</i>	
- Reduce Unemployment Fund (AWF) premium for employees to 0%	2009
<i>Women</i>	
- Increase supplementary combination tax credit (ACK)	2008
- Establish Part-time Plus Task Force	2008
- Convert supplementary combination tax credit into income-based supplementary combination tax credit (IACK)	2009
- Phase out transferability of general tax credit over 15-year period	2009
<i>Older workers</i>	
- Convert premium exemption into a targeted temporary premium discount for older unemployed workers	2009
- Introduce bonus for continuing to work after reaching the age of 62	2009
- Increase statutory retirement age from 65 to 67	2020-2025
<i>Vulnerable groups</i>	
- Implement employment scheme to facilitate the creation of jobs for those receiving benefits under the Work and Social Assistance Act (so-called 'participation jobs')	2008
- Conclude agreements with the 39 regions of the Regional Registration and Coordination Centres (RMCs) to address school drop-out levels	2008
- Introduce a stricter definition of 'appropriate work' in the Unemployment Insurance Act (WW)	2009
- Introduce earned income tax credit (IAK)	2009
- Introduce temporary wage cost subsidy for long-term unemployed under the age of 50 (STAP)	2009
- Introduce integrated services at the regional Locations for Work and Income	2009
- Introduce budget for municipalities to promote labour market participation	2009
- Introduce Investment in the Young Act (WIJ)	2009
- Adjust income benefits for young disabled persons under the Invalidity Insurance (Young Disabled Persons) Act (Wajong)	2010

#### *Administrative burden*

A priority of the government is better regulation and the reduction of the administrative burden ('red tape') as a means of stimulating the economy. The government's integral, problem-driven approach to regulatory burden, where the perception of the entrepreneur takes precedence, has been linked to verifiable targets. The objective of the government is to achieve a net reduction in the administrative burden of 25% compared to the benchmark of 1 March 2007. At the end of the third quarter of 2009, a net reduction of 11% had been realised, according to plan. Actions have been taken with respect to all bottlenecks indicated by the business community. In addition, the government aims to improve the services and information for entrepreneurs and to reduce the burden from legislation imposed by other governments and by Europe ('Better Regulation', and more specifically the EU action programme for reducing the administrative burden for businesses by 25%).

In view of the crisis, the government has set additional objectives towards reducing the cost of doing business. The 'Working on the Future' agreement signed in March 2009 lays down an acceleration agenda for creating more space for businesses to develop their activities and to face the challenges related to the crisis. This acceleration agenda contains 16 measures in the fields of the labour market, construction and living, and with respect to enhancement of the government's approach to businesses. These measures have already been partly implemented. The key assumption of the acceleration agenda is that even though it may be up to the government to try and mitigate the crisis as much as possible, it is mainly up to the businesses to return the economy to economic growth. In doing so, businesses should not be hindered by provisions and procedures that are unnecessarily burdensome and bureaucratic.

The latest National Reform Programme of the Netherlands provides additional information on the various measures taken and their effectiveness.

## Chapter 7 Sustainability of public finances

*As a consequence of the crisis, the sustainability of public finances has clearly deteriorated in the recent period, despite the measures taken at the start of the government term. The government remains committed to tackling the challenges of an ageing population and has decided upon additional sustainability measures to counteract the deterioration of the outlook stemming from the crisis. The sustainability package includes an increase in the retirement age to 67, savings in health care, and a higher taxation on houses with a value above €1 million.*

### **Policies in place before crisis**

Recent international estimates for the sustainability of the Dutch public finances indicate a significant deterioration as a result of the financial crisis. The European Commission estimates the sustainability gap at 6.9% of GDP in its sustainability report 2009. In May 2010 the CPB will publish its four-annual estimate of the Dutch sustainability gap. The government bases its long-term sustainability policy on the CPB figures, because these take account of specific Dutch particularities and also include the indirect taxation on pension benefits. For international comparisons, the EC figures are more useful.

The government is keen to address the challenges of an ageing population. The ageing of the Dutch population will put pressure on the sustainability of public finances. Sustainable public finances are part of the broader concern for responsible intergenerational policymaking. Demographic projections show that with unchanged policies the ratio of pensioners to working persons will double in the period up to 2040. This, in turn, will lead to a widening discrepancy between expenditure and income from taxes and social insurance contributions, since age-related expenditures (on state pension (AOW) and health care) will rise faster than revenues.

At the start of the current government's term in 2007, it was decided to aim to close one third of the then known sustainability gap of about 2% GDP. To this end, measures were introduced along the three general ways to allow the government to tackle the sustainability issue: 1) saving through budget surpluses, 2) increasing labour force participation and 3) implementing reforms in ageing-sensitive institutions (e.g. social provisions):

- 1) Previous chapters have elaborated on the government's budgetary policies

2) Labour force participation in the Netherlands had been rising persistently, and was projected to rise for the years to come, mainly due to increasing participation of women. Measures taken to increase participation include: (i) the gradual abolition of the transferability of the general tax credit between fiscal partners, except for parents with children under the age of six; (ii) the introduction of an earned income tax credit and an individual and income-related tax credit for parents combining work and care, which will make participation in the labour force more rewarding; and (iii) a gradual shift in the tax burden from labour to wealth and pollution (decreasing income taxes will have a positive effect on participation across the board).

3) Steps towards reforming age-sensitive expenditures on state pensions and health care were also taken. First of all, as of 2011, people aged 65 or over and born after 1945 will provide a 'sustainability contribution'. This is implemented by means of a limited indexation of the second tax bracket, which ends in 2009 at € 32.127. To curb expenditures on health care, the deductibility of health expenditures has been reduced. In addition, a private contribution on the basis of the ability to pay will be required under the Exceptional Medical Expenses Act ("AWBZ, Algemene Wet Bijzondere Ziektekosten").

All these policies together would have closed one third of the sustainability gap as estimated at the start of the current government.

Since the start of the government in 2007, the economic outlook has changed dramatically, and with it, the sustainability of Dutch public finances. Although the long-term influence of the financial crisis on economic growth and hence on the sustainability is yet to be determined, it is clear from current estimates that sustainability has deteriorated, despite the measures decided upon at the start of the government. The figures in table 7.1 illustrate this. Without further measures, the government debt is projected to increase rapidly and with it, the interest payments. This would lead to an unsustainable level of government expenditures in 2050.

**Table 7.1 Sustainability of public finances<sup>8</sup>**

% of GDP	2005	2010	2020	2030	2050
<b>Total expenditure*</b>	44.8	44.1	46.7	51.0	60.3
<i>Of which:</i>					
Age-related expenditure	20.5	20.5	22.6	25.6	29.4
Pension expenditures	7.4	6.5	7.8	9.3	10.3
Health care	4.8	64.9	5.3	5.6	5.9
Long-term care	3.4	3.5	4.1	5.4	7.7
<b>Total revenue*</b>	44.5	42.4	42.8	43.3	43.4
Pension reserve fund assets	145	167	209	255	298
<b>Assumptions</b>					
Labour productivity growth	0.8	1.7	1.7	1.7	1.7
Real GDP growth	1.4	1.9	1.5	1.2	1.5
Total participation rates (aged 15 – 64)	77.1	78.8	79.5	79.7	80.4
Population aged 65+ over total population (%)	14.0	15.2	19.5	23.8	26.6

\* These figures have not been published by the Ageing working group. The method is derived from the sustainability report 2009 by the European Commission: the non-age-related revenues and expenditures are kept constant at the 2005 level (taken from table a.3.5 of Public Finance Report 2007). Changes in taxes on pensions and property income, as used in the sustainability assessment, are then added to the revenue projection to make up the grand total. Please note that these figures stem from long-term projections which do not fully incorporate the impact of the financial crisis. Therefore, total expenditure figures for 2010 deviate from short-term expenditure projections for 2010 as found elsewhere in this programme.

### **Policies to enhance sustainability since the crisis**

In response to the economic crisis, the Dutch government agreed upon a sustainability package in March 2009. This package focuses on gradually reforming welfare arrangements. The sustainability package includes three measures. First, the retirement age will be gradually increased from 65 to 67. Second, the government will take measures in healthcare. Third, the € 1 mln cut-off point for determining the percentage of the taxable base value of a personal residence will not be indexed. These three measures together will provide a structural improvement of the sustainability of 1.3 % of GDP.

**Table 7.2 Effects of the sustainability package on the long-term**

	Effect on sustainability in % GDP
Retirement age 65->67	0.7%
Health care expenditures	0.4%
Higher taxes on houses > € 1 mln	0.2%
<b>Total</b>	<b>1.3%</b>

<sup>8</sup> Please note that projecting the costs of an ageing population is done on an irregular and low frequency basis. Economic outlooks with a shorter horizon have a higher frequency but do not lead to updates of AWG projections or CPB ageing projections per se. Therefore a discrepancy may arise between the AWG and CPB assumptions in the first years of the long-term projections. Currently, the 2005 and 2010 figures differ between medium and short-term on the one hand and long-term on the other hand.



The retirement age will be increased gradually. For people who are 55 years or older before 1 January 2010, nothing changes. They will still receive their state pension from the age of 65 onwards. In 2020 the retirement age will be increased to 66 and in 2025 the retirement age will be further increased to 67. The framework for fiscal subsidies to second and third pillar pensions ('Witteveen-kader') will be adapted in one step in 2020, such that the same yearly pension ambition can be achieved, albeit that one needs to work two years longer and the pension starts two years later.

**Box 7.1: Accompanying policy measures for raising the retirement age**

In addition to the general changes with respect to the state old age pension and the fiscal treatment of second and third pillar pensions, flanking policy measures have also been proposed. These are aimed at people with long working histories, people in heavy jobs, and at those that become unemployed at a high age.

*Long working histories*

People with a working history of over 42 years whom are still working at 65 will be given the choice to have their state pension start one or two years before the general state pension age of 67 years. If they so choose, the level of the state pension will be adjusted permanently by up to 13%, so that the current value of the future state pension receipts is unchanged. As the current data records do not go back long enough to verify a working history of 42 years, the requirement will be gradually increased starting from a working history of the last 15 years in 2020. Only those with sufficient secondary income will qualify for this measure to avoid that these people may fall below the supplementary benefit level.

*Strenuous jobs*

The prevention of premature wearing out of workers is the point of departure. To achieve this, a number of measures will be taken with regard to strenuous jobs. First of all, the Working Conditions Act will be changed and a mutual learning duty will be taken up in law. Employers need to set up a programme aimed at lasting employability. Second, employers are required to offer an alternative job (a job that is not categorised as strenuous) after at most thirty years of work in strenuous jobs. If employers fail to do so, they are required to pay up to 14% of annual salary for up to ten years in a special fund (for which an attractive fiscal regime will apply), enabling the employee to retire two years before the official state pension age of 67 years. Employees may choose to reject the alternative job offer and continue their 'heavy' job, which releases employers from the obligation to contribute to the fund. Social partners may propose certain jobs to be qualified

as strenuous jobs. The final list of jobs is decided upon by the minister of Social Affairs, who bases his decision in part on the inflow in disability schemes.

*Unemployed at high age*

Elderly unemployed or partially disabled of whom the social benefits terminate after age 65 will be eligible for a new allowance to bridge the gap until the state pension age. However, if one's income (excluding assets) exceeds a certain threshold one is not eligible for the supplementary benefit at the social assistance level.

With respect to healthcare, the precise policy package will be decided upon in 2010. The package will need to be such that it improves sustainability by 0.4% of GDP, to which the government has committed itself. At least 0.2% will be achieved by reforming the health care allowance benefit, a tax credit to lower and middle income families. For the remaining part, additional measures will be taken to limit acute care expenditure by another 0.2% of GDP. The intention is to introduce additional cost-containing policies to strengthen the incentives for efficiency. The package is likely to include a higher amount of freely negotiable hospital fees and adjustments among hospital governance that strengthen the position of the administration versus the medical staff. In addition, to ensure that health insurers will bear greater risks, public reinsurance will be phased out. Finally, integrated care will be intensified for the chronically ill. If necessary, these policies will be complemented by additional measures.

## Chapter 8 Institutional features of public finances

*Public finances in the Netherlands are based on a set of fiscal rules that are enshrined in the trend-based budgetary policy. The trend-based budgetary policy is characterised by fixed expenditure ceilings, a strict separation of expenditures and revenues, and a single annual decision-making moment. To deal with the exceptional circumstances of the crisis, the government has placed expenditures on unemployment benefits and the wage-price differential outside of the expenditure ceilings. In determining the set of fiscal rules, the government is assisted by the Budgetary Framework Commission and independent institutions as the CPB and Statistics Netherlands.*

### 8.1 Fiscal rules of the Government

#### *Trend based budgetary policy*

The trend-based budgetary policy is the key feature of the set of fiscal rules in the Netherlands. The three key characteristics of the rules are the following: (1) fixed real expenditure ceilings, (2) a strict separation between expenditure and revenue, and (3) a single decision-making moment for the new budget.

1) For every year in the period 2008-2011 fixed ceilings have been set (see the Budget Memorandum 2008). The scope of the respective ceiling remains unchanged: i) state government; ii) health care; and iii) social security and labour market. The expenditure ceilings are measured in real terms (the deflator is the price of national expenditure).

2) A strict separation between expenditure and revenue is in force. With regard to revenues, i.e. taxes, social security contributions and gas revenues, automatic stabilisation on this income side of the budget is allowed to work freely during the government's term.

3) Every spring, the government decides on the (expenditure side of the) new budget and on the execution of the current budget. The government takes a closer look at revenues and measures concerning the purchasing power of specific income groups in August. The single decision-making moment provides relative stability in the fiscal policy regime.

Another important element for the day-to-day fiscal management is that ministries should solve expenditure overruns with expenditure cuts within their own budget.

#### *Update fiscal rules due to the financial and economic crisis*

The set of fiscal rules has been updated by the government at the end of 2008 and at the beginning of 2009 due to the financial and economic crisis. It is not the first time since the introduction of the 'trend-based budgeting policy' in 1994 that changes were introduced in the set of fiscal rules. The financial crisis made it necessary to update the fiscal rules in order to address the unprecedented circumstances and the large interventions by the government in financial markets.

In the spring of 2009 the current government decided to correct expenditure ceilings for the expenditures on unemployment benefits and for the wage-price differential. As a result, the expenditure ceilings are less vulnerable to swings in the economy, which proved to be exceptionally large in this crisis. These two corrections will remain in place at least until the end of the current government term. In its report, the Budgeting Framework Commission will make a recommendation on whether to continue correcting the expenditure ceilings.

The government also decided to keep all costs and revenues resulting from the interventions in the financial sector outside of the expenditure ceilings. Otherwise it would have been possible that measures due to the financial crises would have created spending room under the expenditure ceilings since interest expenditures, according to the Dutch fiscal rules, are excluded from the expenditure ceilings, while dividend receipts are included. Also, premia and possible compensation payments resulting from the guarantee of bank loans and the deposit guarantee scheme are not part of the expenditure ceilings.

#### *Deficit reduction Act*

It has been decided in the spring of 2009 in the context of the Supplementary Policy Agreement to introduce a Deficit Reduction Act in 2011. The (draft) Deficit Reduction Act is based on the requirements of the Stability and Growth Pact and is designed to legally ensure deficit reduction efforts by the present and the future governments.

**Box 8.1: Deficit Reduction Act**

One of the measures with regard to the consolidation of public finances in the medium-term involves the introduction of a Deficit Reduction Act in 2011.<sup>9</sup> The (draft) Deficit Reduction Act is based on the requirements of the Stability and Growth Pact (SGP) and is designed to enhance the enforcement of deficit reduction efforts by present and future governments. In short, the (draft) Deficit Reduction Act consists of the following elements:

- 1) An annual improvement of the structural deficit by *at least* 0.5 percentage point until the Medium-term Objective for the Netherlands is met;
- 2) A more substantial effort to be made in 'good times', where good times are defined in conformity with the SGP.
- 3) Only in 'exceptional circumstances' may the extent of the deficit reduction be reconsidered, where 'exceptional circumstances' are defined in conformity with the SGP ;
- 4) Council Recommendations in case of an Excessive Deficit Procedure have to be adhered to at all times.

The Deficit Reduction Act includes information requirements for local governments and establishes a limit for the contribution of local governments to the general government deficit. According to the Deficit Reduction Act, the deficit of local governments may not exceed 0.5% GDP. The Deficit Reduction Act also foresees the application of sanctions in the event that this limit is exceeded: local governments can be fined if the Dutch government is sanctioned for exceeding the European deficit norm *and* if the Dutch local governments exceed their own limit. The terms and the conditions under which local governments should report on their EU-balance is also mentioned in the Deficit Reduction Act.

*Budgetary reviews*

The Government has decided on a budgetary review for 20 policy fields. The aim is to produce a wide range of cost reduction options for each policy area and to include at least one scenario with a 20% expenditure reduction option. More detailed information on the budgetary reviews was included in chapter 6.

**8.2 Budgetary Framework Commission**

The reports of the Budgetary Framework Commission (BFC) are a specific feature of the process of designing fiscal policy. This high-level advice group of civil servants (including the central bank and the CPB) is tasked to give recommendations for fiscal policy in the next government's term. The appropriate time-schedule is one advice every four years, to be presented in the year prior to general elections. Reports of the BFC have been influential in the past; e.g.

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<sup>9</sup> In Dutch: de Wet Tekortreductie Rijk en Medeoverheden (TReM).

regarding the separation between expenditures and revenues, and the budgetary consequences of an ageing population.

#### **Box 8.2: Budgetary Framework Commission**

The Budgetary Framework Commission advises every four years on the challenges for fiscal policy. The BFC roughly focuses on two separate questions: what alterations are advisable to the current fiscal policy? And what fiscal targets should a new administration pursue? Note that whereas the BFC will focus on the budgetary targets, the Fundamental Budget Review will provide the input for the political decisions on the measures necessary to achieve these targets.

The BFC was established in 1971 to deliver the foundations of the then operative structural fiscal policy. After the first years in which a number of reports were produced, the Commission presented advice on fiscal policy prior to elections and the formation of a new government. This is still current practice, and the advice of the BFC generally plays an important role during the formation of a new government. For instance, the current trend-based fiscal policy was recommended by the Commission. The BFC's last report (in 2006) focused on the need for budget surpluses to cope with the challenges of an ageing population and presented options how to best achieve this objective.

The assignment for a new advice of the Budgetary Framework Commission is determined by the government. The report is produced without further political involvement. The BFC is non-partisan and consists of civil servants. The Treasurer acts as chairman. The Ministries of General Affairs, Finance, Economic Affairs, Social Affairs and Employment, the Interior and Health, Welfare and Sport are represented in the Commission. In addition to these departments, the CPB and De Nederlandsche Bank (DNB) also are part of the BFC.

The next BFC advice is expected before the summer of 2010. The attention of the BFC will mainly be focused on the (speed of the) recovery of public finances in the aftermath of the financial and economic crisis, given the inevitable budgetary adjustments that will have to be made. This is done in the context of certain trends in government revenues and expenditures, such as the effect of population ageing, autonomous growth of several tax expenditures and the growth in revenues and expenditures relative to GDP growth. The BFC has also been asked to elaborate on how best to deal with the increased level of uncertainty in designing fiscal policy.

### **8.3 Relationship between the quality of public finances and institutions**

The existence of independent organizations in the field of forecasting and official statistics contributes to the quality of public finances in the Netherlands. The Netherlands has a longstanding tradition in the area of budgetary institutions. The statistical office (Statistics Netherlands) has been in existence for over 100 years and the forecasting agency, the Netherlands Bureau for Economic Policy Analysis, for over 50 years.

#### *Statistical governance*

Statistics Netherlands is the official producer of most Dutch macroeconomic statistics. Key indicators such as GDP, CPI, government deficit and debt and the national accounts are compiled by Statistics Netherlands. All public finance data of past years, whether on an annual or a quarterly basis, is compiled by Statistics Netherlands. Statistics on the quality of public finances such as COFOG statistics are also compiled by Statistics Netherlands.

The status of Statistics Netherlands has a strong legal basis in the Statistics Act 2003. Statistics Netherlands has the legal status of an independent public body and operates on the basis of an independent statute. Its independence allows it to compile reliable and high quality statistics on public finances. Since 2005, the terms of cooperation between Statistics Netherlands and the Ministry of Finance has been laid down in a protocol.

#### *Independent forecasts*

The past few years have resulted in a discussion on the role of independent fiscal councils as guardians of sound budgetary policymaking. In 2006, the IMF took a closer look at the Dutch budgetary framework in its fiscal ROSC for the Netherlands.<sup>10</sup> According to this report, one of the outstanding features was CPB's unique role in the policymaking process owing to its technical reputation and its independence.

The CPB provides the economic outlook as well as its own budgetary outlook. The economic outlook is used as independent input into the budget making process, while the budgetary outlook provides an independent second opinion on the government's budget and institutional measures. Moreover, the Netherlands Bureau for Economic Policy Analysis performs cost-benefit calculations of public investment projects. Finally, all major political parties generally have the budgetary and economic consequences of their election programmes analysed by

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<sup>10</sup> IMF (2006), "The Netherlands - Report on the Observance of Standards and Codes – Fiscal Transparency Module"

the CPB. The CPB hence provides a strong incentive to political parties not to present unrealistic promises.

All in all, the IMF concluded: "The Netherlands Bureau for Economic Policy Analysis appears to span the full spectrum of activities identified in the recent IMF's analysis of independent Fiscal Councils."



## ANNEX Tables<sup>11</sup>

**Table A.1** Macroeconomic prospects

	ESA Code	2008	2008	2009	2010	2011	2012
		Level (bln €)	rate of change	rate of change	rate of change	rate of change	rate of change
Real GDP	B1*g	595.9	2.0	-4	1.5	2	2
Nominal GDP (€ bln)	B1*g	595.9	4.8	- 3¾	1½	3	3
<b>Components of real GDP</b>							
Private consumption expenditure	P.3	272.5	1.3	-2½	¼	1.5	1.5
Government expenditure	P.3	151.8	2.5	2¼	¾	¼	-½
Gross fixed capital formation	P.51	121.7	4.9	- 11¾	- 4	6	6
Changes in inventories (?)	P.52+ P.53	0.2	0.3	- ½	1	0	0
Exports of goods and services	P.6	457.4	2.7	- 8¾	4¾	6.5	6
Imports of goods and services	P.7	407.6	3.7	- 9¼	3½	5	5
<b>Contributions to real GDP growth</b>							
Final domestic demand		546.1	2.1	- 3	- ¾	1¼	1¼
Changes in inventories (?)	P.52+ P.53	0.2	0.3	- ½	1	0	0
External balance of goods and services	B.11	49.8	- 0.4	- ½	1¼	¾	¾

**Table A.1b** Price developments

	ESA Code	2008	2008	2009	2010	2011	2012
		level	rate of change	rate of change	rate of change	rate of change	rate of change
<b>GDP deflator</b>		100	2.7	¼	0	1	1
Private consumption deflator		100	2.1	0	1	1	1
<b>HICP</b>		100	2.2	1	1	1	1
Public consumption deflator		100	3.3	2¾	1½	1	1
Investment deflator		100	2.1	1¾	¾	1	1
<b>Export price deflator</b>		100	4.7	- 5½	- ¼	1	1
<b>Import price deflator</b>		100	4.5	- 5	1¼	1	1

<sup>11</sup> Please be aware that tables present rounded numbers. In some cases the sums of lines may therefore deviate from the individual lines due to rounding.

**Table A.1c** Labour market developments

	ESA Code	2008	2008	2009	2010	2011	2012
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
<b>Employment (x thousand persons)</b>		8734	2.4	- ¼	- 1½	½	½
Employment (bln hours worked)		12.1	1.2	- 1½	- 2¼	½	½
<b>Unemployment rate (% of labour force)</b>		304 (x thousand persons)	3.9	5	6½	6½	6½
<b>Labour productivity (persons)</b>		60.2	2.4	- 3½	3¼	1½	1½
Labour productivity, hours worked		44.0	3.6	- 2¼	3¾	1½	1½
<b>Compensation of employees</b>	D.1	295.1	5.2	1¾	- ¼	2½	2½
<b>Compensation per employee</b>		49.2	3.8	2¾	2¼	2	2

**Table A.1d** Sectoral balances

% of GDP	ESA Code	2008	2009	2010	2011	2012
<b>Net lending/borrowing vis-à-vis the rest of the world</b>	B.9	4.2	4½	5¾	6¼	6¼
<i>Of which:</i>						
- Balance on goods and services		8.3	7½	7¾	8	8
- Balance of primary incomes and transfers		- 2.6	- 1½	- ¼	- ¼	- ¼
- Capital account		-1.5	- 1¼	- 1¾	-1½	-1½
<b>Net lending/borrowing of the private sector</b>		3.5	9¼	11¾	11¼	10¾
<b>Net lending/borrowing of general government</b>		0.7	-4.9	-6.1	-5.0	-4.5
<b>Statistical discrepancy</b>		0.0	0.0	0.0	0.0	0.0

**Table A.2** General government budgetary prospects

	ESA Code	2007	2007	2008	2009	2010	2011	2012
		level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
<b>Net lending (EDP B9) by sub sector</b>								
<b>1. General government</b>	S.13	1095	0.2	0.7	-4.9	-6.1	-5.0	-4.5
<b>2. Central government</b>	S.1311	2838	0.5	0.5	-2.9	-4.4	-4.0	-3.3
<b>3. State government</b>	S.1312	2847	0.5	0.5	-2.9	-4.4	-4.0	-3.3
<b>4. Local government</b>	S.1313	-1147	-0.2	-0.4	-0.6	-0.7	-0.6	-0.4
<b>5. Social security funds</b>	S.1314	-596	-0.1	0.6	-1.4	-1.0	-0.4	-0.9
<b>General government (S13)</b>								
<b>6. Total revenue</b>	TR	253637	44.6	45.6	44.4	44.3	44.9	45.5
<b>7. Total expenditure</b>	TE	252542	44.4	44.9	49.3	50.4	49.9	50.0
<b>8. Net lending/borrowing</b>	EDP B9	1095	0.2	0.7	-4.9	-6.1	-5.0	-4.5
<b>9. Interest expenditure</b>	EDP D.41	12544	2.2	2.1	2.4	2.4	2.4	2.5
<b>10. Primary balance</b>		13639	2.4	2.8	-2.5	-3.7	-2.6	-2.0
<b>11. One-off and other temporary values</b>		-1034	-0.2	-0.2	0.4	0.0	0.0	0.0
<b>Selected components of revenues</b>								
<b>12. Total taxes (12=12a+12b+12c)</b>		141050	24.8	24.1	24.2	23.4	23.6	23.9
12a. Taxes on production and imports	D.2	71163	12.5	12.1	11.9	11.7	11.8	11.9
12b. Current taxes on income, wealth etc.	D.5	67949	11.9	11.6	12.0	11.4	11.5	11.7
12c. Capital taxes	D.91	1877	0.3	0.3	0.3	0.3	0.3	0.3
<b>13. Social contributions</b>	D.61	81405	14.3	15.2	14.2	15.2	15.6	15.7
<b>14. Property income</b>	D.4	14836	2.6	3.4	2.9	2.5	2.5	2.7
<b>15. Other revenues</b>		16346	2.9	2.9	3.1	3.2	3.2	3.2
<b>16.=6. Total revenue</b>	TR	253637	44.6	45.6	44.4	44.3	44.9	45.5
<b>Tax burden (D.2+D.5+D.61+D.91-D995)</b>		221067	38.9	39.1	38.1	38.3	38.7	39.0

Selected components of expenditure								
<b>17. Compensation of employees and intermediate consumption</b>	D.1+P.2	93365	16.4	16.5	17.8	17.8	17.5	17.2
- 17a. Compensation of employees	D.1	52353	9.2	9.1	9.9	9.9	9.7	9.5
- 17b. Intermediate consumption	P.2	41012	7.2	7.4	8.0	7.9	7.8	7.7
<b>18. Social payments (18=18a+18b)</b>		114851	20.2	20.2	22.3	22.9	22.4	22.0
18a. Social transfers in kind supplied via market producers	D.6311. D63121. D63131	55912	9.8	9.8	10.9	10.9	10.6	10.5
18b. Social transfers other than in kind	D.62	58939	10.4	10.4	11.5	12.0	11.8	11.5
<b>19.=9. Interest expenditure</b>	EDP D.41	12544	2.2	2.1	2.4	2.4	2.4	2.5
<b>20. Subsidies</b>	D.3	7154	1.3	1.2	1.4	1.4	1.4	1.4
<b>21. Gross fixed capital formation</b>	P.51	19078	3.4	3.5	3.7	3.8	4.1	4.4
<b>22. Other</b>		5550	1.0	1.3	1.4	2.0	2.2	2.4
<b>23.=7. Total expenditure</b>	TE	252542	44.4	44.9	49.3	50.4	49.9	50.0
<b>Government consumption (nominal)</b>	P3	143988	25.3	25.5	27.8	27.9	27.0	26.0

**Table A.3** General government expenditure by function

% of GDP	COFOG Code	2007	2008	2012
1 General public service	1	10.4	10.6	10.8
2 Defence	2	1.2	1.1	1.2
3 Public order safety	3	1.7	1.7	1.8
4 Economic affairs	4	3.4	3.7	4.7
5 Environmental protection	5	0.8	0.8	0.9
6 Housing and community amenities	6	0.9	0.9	1.3
7 Health	7	8.8	8.7	10.2
8 Recreation, culture and religion	8	1.3	1.3	1.8
9 Education	9	5.1	5.0	5.5
10 Social protection	10	10.8	11.1	11.8
11 Total expenditure	TE	44.4	44.9	50.0

**Table A.4** General government debt developments

% of GDP		2008	2009	2010	2011	2012
<b>1. Gross debt</b>		58.2	62.3	67.2	69.6	72.5
<b>2. Change in gross debt ratio</b>		12.7	4.1	5.0	2.3	2.9
<b>3. Primary balance</b>						
		2.8	-2.5	-3.7	-2.6	-2.0
<b>4. Interest expenditure</b>	EDP D.41	2.1	2.4	2.4	2.4	2.5
<b>5. Stock-flow adjustment</b>		13.4	-0.8	-1.1	-2.7	-1.6
<i>of which:</i>						
- differences between cash and accruals		0.3	0.5	0.0	-0.9	0.1
- Net accumulation of financial assets		14.1	-3.3	-0.3	0.3	0.3
<i>of which:</i>						
- privatisation proceeds		0.0	0.0	0.0	0.0	0.0
- Valuation effect and other		-1.0	2.0	-0.8	-2.0	-2.0
<b>PM: implicit interest rate</b>		4.3	3.7	3.8	4.0	4.0
6. Liquid financial assets		NA	NA	NA	NA	NA
7. Net financial debt (7=1-6)		NA	NA	NA	NA	NA

**Table A.5** Cyclical developments

	ESA Code	2008	2009	2010	2011	2012
<b>1. Real GDP growth</b>		2.0	-4	1½	2	2
<b>2. Net lending of general government</b>	EDP B.9	0.7	-4.9	-6.1	-5.0	-4.5
<b>3. Interest expenditure</b>	EDP D.41+ FISIM	2.1	2.4	2.4	2.4	2.5
<b>4. One-off and other temporary measures</b>		-0.2	0.4	0.0	0.0	0.0
Potential GDP growth		1.9	1.4	1.0	1.5	1.5
<i>Contributions to growth:</i>						
- Labour		0.4	0.3	0.1	0.2	0.2
- Capital		0.8	0.4	0.3	0.4	0.4
- Total factor productivity		0.7	0.7	0.7	0.8	0.8
6. Output gap		2.3	-3.2	-2.7	-2.2	-1.6
7. Cyclical budgetary component		1.3	-1.8	-1.5	-1.2	-0.9
8. Cyclically-adjusted balance (2-7)		-0.6	-3.1	-4.6	-3.8	-3.6
9. Cyclically-adjusted primary balance (8-3)		-2.7	-5.5	-7.0	-6.2	-6.1

**Table A.6** Divergences from previous update

	ESA Code	2008	2009	2010	2011	2012
<b>Real GDP growth (%)</b>						
Previous update		2.25	1.25	1.75	1.75	NA
Current update		2.0	-4.0	1.5	2.0	2.0
Difference		-0.25	-5.25	-0.25	0.25	NA
<b>General government net lending (% of GDP)</b>	EDP B.9					
Previous update		1.2	1.2	0.8	1.1	NA
Current update		0.7	-4.9	-6.1	-5.0	-4.5
Difference		-0.5	-6.1	-6.9	-6.1	NA
<b>General government gross debt (% of GDP)</b>						
Previous update		42.1	39.6	38.0	36.2	NA
Current update		58.2	62.2	67.4	69.6	72.5
Difference		16.1	22.6	29.4	33.4	NA

**Table A.7** Sustainability of public finances

% of GDP	2005	2010	2020	2030	2050
<b>Total expenditure*</b>	44.8	44.8	47.7	52.6	64.4
<i>Of which:</i>					
age related expenditure	20.5	20.5	22.6	25.6	29.4
Pension expenditures	6.9	6.5	7.8	9.3	10.3
Social security expenditures	1.7	1.5	1.5	1.5	1.5
Old-age and early pensions	4.6	4.5	5.9	7.6	8.7
Other pensions (disability, survivors)	2.3	2.0	1.9	1.7	1.6
Occupational pensions	4.6	5.0	6.7	9.0	11.0
Health care	4.8	4.9	5.3	5.6	5.9
Long-term care	3.4	3.5	4.1	5.4	7.7
Education expenditure	4.8	4.6	4.4	4.4	4.5
Other age-related expenditure	0	0	0	0	0
Interest rate expenditure	2.4	2.4	3.2	5.1	13.1
<b>Total revenue*</b>	44.5	44.1	43.6	43.6	42.9
<i>Of which: property income</i>	2.3	1.9	1.4	1.4	0.7
<i>Of which: from pensions contributions</i>	4.0	4.0	4.0	4.0	4.0
Pension reserve fund assets	145	167	209	255	298
<i>Of which: consolidated public pension fund assets</i>	0	0	0	0	0
<b>Assumptions</b>					
Labour productivity growth	0.8	1.7	1.7	1.7	1.7
Real GDP growth	1.4	1.9	1.5	1.2	1.5
Participation rate males (aged 15 -64)	84.0	83.9	82.6	82.1	82.5
Participation rate females (aged 15 – 64)	70.1	73.6	76.3	77.2	78.2
Total participation rates (aged 15 – 64)	77.1	78.8	79.5	79.7	80.4
Unemployment rate	3.5	3.0	3.0	3.0	3.0
Population aged 65+ over total population (%)	14.0	15.3	19.8	24.1	26.7



**Table A.8** External assumptions

	2008	2009	2010	2011	2012
Short-term interest rate (annual average)	4.6	1¼	1	1.5	2
Long-term interest rate (annual average)	4.3	3¾	3¾	4	4
USD/€ exchange rate (annual average)	1.47	1.40	1.49	1.49	1.49
Nominal effective exchange rate	3.7	-¾	2½	0	0
World GDP growth	2.8	- 1	3½	4	4
EU GDP growth	0.6	- 4	1½	2	2
World GDP growth excluding EU	3.3	-¼	4¼	5	5
Growth of relevant foreign markets	1.6	-12¾	7½	6½	6½
World import volumes, excluding EU	2.5	-12¼	10	10	10
Oil prices (Brent, USD per barrel)	97	62	77	77	77