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**Analysis by the Commission services of the budgetary situation in the Netherlands following the adoption of the COUNCIL RECOMMENDATION to the Netherlands of 2 December 2009 with a view to bringing an end to the situation of an excessive government deficit**

*Accompanying the document*

**Recommendation for a**

**COUNCIL RECOMMENDATION**

**with a view to bringing an end to the situation of an excessive government deficit in the Netherlands**

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## **1. INTRODUCTION**

On 2 December 2009, the Council decided, in accordance with Article 126(6) TFEU, that an excessive deficit existed in the Netherlands and issued a recommendation to correct the excessive deficit by 2013 at the latest, in accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure.

In order to bring the general government deficit below the 3% of GDP reference value in a credible and sustainable manner, the Dutch authorities were recommended to implement the fiscal measures in 2010 as envisaged and, thereafter, to: '(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.' The Council established a deadline of 2 June 2010 for effective action to be taken.

On 15 June 2010, the Commission concluded that, based on the Commission services' 2010 Spring Forecast, the Netherlands had taken effective action in compliance with the Council recommendation of 2 December 2009 aimed at correcting the excessive deficit by the established deadline and considered that no additional step in the excessive deficit procedure was therefore necessary at that point in time. In particular, the Netherlands was found to have implemented the fiscal measures in 2010 as envisaged in the 2010 budget.

Since the deadline established by the Council for correcting the excessive deficit is approaching, this document provides an assessment of whether the Netherlands has undertaken effective action towards the correction of its excessive general government deficit, and suggests a new adjustment path that would durably bring the general government deficit below the 3% of GDP threshold. In particular, the document examines the policy and budgetary developments since the Commission communication to the Council of 15 June 2010.

## **2. RECENT MACRO-ECONOMIC AND BUDGETARY DEVELOPMENTS AND OUTLOOK FOR 2014**

The Netherlands is experiencing a protracted economic downturn which worsened since 2011 (Table 1). Real GDP growth turned out to be much lower than foreseen in the scenario underpinning the 2009 EDP Council recommendation. Negative wealth and confidence effects account for a significant part of the underperformance. These relate to balance sheet adjustments, which to a considerable extent reflect adjustments in the housing market. Following a contraction of real GDP by 3.7% in 2009, economic growth rebounded moderately into positive territory in 2010 and 2011, with real GDP growth of 1.6% and 1% respectively, and was mainly driven by the improvement in global demand, resulting in a positive contribution to growth of net exports.

Since the second quarter of 2011, quarter-on-quarter economic growth in the Netherlands has been negative, apart from the first half of 2012, when it was marginally above zero. Real GDP decreased by 1% in the third quarter of 2012, its strongest decline since 2009. In the fourth quarter output declined even further by 0.4%, with private consumption decreasing by 1.1%,

to a level last reached in 2001. Despite a small rebound in the first quarter of 2013 largely on the back of higher energy consumption, quarterly private consumption growth had been negative since the first quarter of 2011. This mainly reflects weak household disposable income, the impact of consolidation measures, as well as negative wealth effects from declining house prices and cuts in pension allowances from second pillar pension funds. Moreover, sustained uncertainty and subdued expectations, resulting in consumer confidence hovering around historical lows, continue to weigh on household consumption in particular. In 2012, real GDP contracted by 1%, with the only positive contribution coming from the external side, largely on the back of a strong trade surplus in goods.

According to the Commission services' 2013 Spring Forecast real GDP growth is forecast to remain negative in 2013 at -0.8%, although it is expected to return gradually to positive territory from the second quarter of the year onwards. Trade developments are expected to contribute to the recovery, whereas domestic demand is forecast to remain depressed well into 2013. Uncertainty regarding the general economic outlook, implementation of reform proposals and possible additional consolidation measures put an additional drag on domestic demand. In 2014, domestic demand should begin to pick up gradually, supporting a fragile recovery, with real GDP increasing by 0.9%.

**Table 1: Comparison of macroeconomic developments and forecasts**

	2009		2010		2011		2012		2013		2014	
	COM AF 09	outturn	COM AF 09	outturn	COM AF 09	outturn	COM AF 09	outturn	COM AF 09	SP 13	COM AF 09	SP 13
Real GDP (% change)	-4.5	-3.7	0.3	1.6	1.6	1.0	NA	-1.0	NA	-0.4	NA	1.1
Contribution to growth:												
Domestic demand	-3.0	-2.1	-1.2	-1.0	0.4	0.6	NA	-1.5	NA	-1.1	NA	0.6
Change in inventories	-0.5	-0.4	0.4	1.2	0.0	-0.1	NA	0.1	NA	-0.2	NA	0.0
Net exports	-1.0	-1.1	1.0	1.4	1.1	0.5	NA	0.4	NA	0.9	NA	0.4
Employment (% change)	-0.5	-1.1	-2.5	-0.6	-1.4	0.5	NA	-0.9	NA	-0.4	NA	0.1
GDP deflator (% change)	1.0	0.1	1.0	1.1	1.4	1.2	NA	0.7	NA	1.6	NA	1.6
Output gap (% of potential GDP)	-2.7	-2.7	-3.1	-1.7	-2.4	-1.4	NA	-2.5	NA	-3.5	NA	-3.0
Potential output growth	1.1	1.0	0.7	0.6	0.9	0.7	NA	0.2	NA	0.3	NA	0.6

Source: Commission services' 2009 Autumn Forecast (COM AF 09), Stability Programme 2013 (SP 13), AMECO

The Netherlands had chosen to delay fiscal adjustment until 2011. This approach was endorsed in the 2009 Council recommendation, which specifically recommended that the 2010 budget be implemented while consolidation should start only in 2011. In response, the Netherlands initially designed a multi-annual package of mainly expenditure-based measures over the period 2011-2015, aimed at achieving an earlier-than-recommended correction of the excessive deficit.

After some over-performance of real GDP in 2009 and 2010 compared to the Commission services' 2009 Autumn forecast underlying the EDP recommendation, economic performance in the Netherlands deteriorated significantly from 2011 onwards. This translated into a similar development in public finances, with some initial over-performance to the budgetary targets until and including 2011. In 2011, the general government balance reached -4.5% of GDP.

Subsequently, the headline deficit improved to 4.1% of GDP in 2012 and is expected to decrease further to 3.6% in 2013<sup>1</sup>. Without additional policy measures, the deficit is forecast at 3.6% of GDP in 2014, reflecting the adverse impact of economic headwinds on the budget deficit as the authorities set out to continue a restrictive fiscal course according to the measures embedded in the multi-annual fiscal adjustment path as confirmed in the 2013 stability programme. The unadjusted structural balance is expected to improve by around 0.7

<sup>1</sup> The SF2013 includes the measures foreseen for 2014 on the basis of the Coalition Agreement, but not the additional consolidation package totalling €4.3 bln. presented on 1 March 2013, as it has been put on hold until August following the agreement with social partners ("Sociaal Akkoord") on 11 April 2013.

% of GDP per year on average over the adjustment period 2010-2013 but to deteriorate in 2014 by around 0.3 pp. On the basis of the Commission services' 2013 Spring Forecast 2013, the average fiscal effort over the period 2011-2013 would thus be close to the required  $\frac{3}{4}$ % of GDP without further adjustments for shortfalls in projected growth or composition effects. The adverse fiscal developments reflect nominal and real GDP growth as well as potential growth falling short of what had been expected at the time the 2009 EDP recommendation was formulated (Table 1).

Debt dynamics in the Netherlands have been unfavourable. In 2008, significant government operations to support Dutch banks had been a major factor pushing up the government debt ratio. On the basis of the Commission services 2013 Spring Forecast the debt ratio is expected to steadily increase to 71.2% of GDP in 2012, 74.6% of GDP in 2013 and 75.8% of GDP in 2014. This is predominantly the result of persistent headline deficits in combination with anaemic nominal GDP growth, whilst EFSF and ESM operations attributed to the government debt only have a relatively small upward effect. The uptick in the expected gross debt ratio for 2013 includes debt-increasing operations equivalent to some 1% of GDP related to the nationalisation of SNS Reaal in early 2013 (on top of the deficit-enhancing measures amounting to around 0.6% of GDP).

Turning to the driving forces of the deficit, swings in economic growth have mainly affected government revenues. The initial recovery from the financial crisis, with stronger-than-expected economic activity in 2010 and the first part of 2011, at first led to a fairly strong revenue performance (Table 2 in section 3.1). However, subsequently revenue fell short compared to plans, particularly in the second half of 2011 and in 2012, in the wake of faltering growth. This adverse pattern is expected to continue, largely driving the weak deficit outlook. Overall trends mirror the cyclical sensitivity of revenue which the Netherlands typically exhibits. The increase in expenditure in 2010, a year of fiscal policy accommodation, occurred in line with a better-than-expected economic performance, with a moderate development in subsequent years as savings measures started weighing in. In accordance with the Dutch fiscal framework (implying a strict division between revenues and expenditures, i.e. automatic stabilisation on the revenue side), which has been deemed good EU practice, expenditure overruns have to be compensated within the ceilings.

At the current juncture, bringing the headline deficit below 3% of GDP in 2013 is out of reach. This is also acknowledged in the 2013 stability programme, which instead commits to correcting the excessive deficit in 2014. The expected general government balance for 2013 as embedded in the stability programme is broadly in line with the Commission services' 2013 Spring Forecast 2013 and risks to this projection appear by and large balanced. The headline deficit projection for 2014 reflects a no policy change scenario in the Commission services' 2013 Spring Forecast 2013 baseline (which does not include the savings package of EUR 4.3 bn or around 0.6% of GDP originally presented on 1 March 2013 but thereafter withdrawn by the government in April 2013 until further notice in the wake of the agreement with social partners).

In the 2013 stability programme the Dutch authorities commit themselves to additional savings measures, should these be needed to bring the headline general government deficit below the 3% of GDP threshold in 2014. However, non-negligible implementation risks are attached to the fiscal outlook for 2014 and beyond. As regards measures embedded in the coalition agreement, these risks originate mainly from the foreseen efficiency gains planned to be achieved by decentralising tasks to municipalities. The 2013 stability programme mentions that an additional savings package of EUR 4.3 bn for 2014, withdrawn by the government following the agreement with social partners, may have to be revived and included in the

2014 budget (due to be presented to Parliament in September), should further savings be necessary to correct the excessive deficit in 2014. Following the stakeholders agreement on health care of end-April 2013, the voluntary wage freeze in health care (0.1 to 0.2 % of GDP) is of the table and thus can no longer be part of the package, so other measures will have to be included. Moreover, the Commission services' 2013 Spring Forecast 2013 suggests that additional measures exceeding the amount of € 4.3 bn provisioned for in the stability programme will be called for in order to bring the headline deficit below 3% of GDP in 2014.

### 3. EFFECTIVE ACTION

#### 3.1. Background information

The current assessment of the effective action is based on the Commission services 2013 Spring Forecast. It takes into account the economic and budgetary developments since the last Council recommendation under Article 126(7) of the TFEU was issued in December 2009. The assessment starts by comparing the recommended fiscal effort in the Council recommendation, the apparent fiscal effort, measured by the average annual change in structural budget balance, and the adjusted structural effort. The adjustment of the change in the structural balance takes into account (i) the impact of revisions in potential output growth compared to that underlying the growth scenario in the Council recommendation, and (ii) the impact on revenue of revisions of the tax content of economic activity (composition of economic growth or of other windfalls/shortfalls) relative to what is implied by the standard long-term elasticities. This top-down approach in the assessment is complemented by a careful analysis, including a bottom-up assessment of consolidation measures undertaken by the Dutch government.

**Table 2: Total government expenditure and revenue developments**

	2009	2010			2011			2012			2013			2014		
	outturn % of GDP	COM AF 2009 % of GDP	COM SF 2013 % of GDP	outturn % of GDP	COM AF 2009 % of GDP	COM SF 2013 % of GDP	outturn % of GDP	COM AF 2009 % of GDP	COM SF 2013 % of GDP	outturn % of GDP	COM AF 2009 % of GDP	COM SF 2013 % of GDP	outturn % of GDP	COM SF 2009 % of GDP	COM SF 2013 % of GDP	outturn % of GDP
<b>Revenue</b>	46.0	44.8		46.2	45.1		45.4			46.4			47.3			47.2
<i>of which:</i>																
-Taxes on production and imports	11.9	12.0		12.1	11.5		11.5			11.3			12.0			12.1
-Current taxes on income, wealth, etc.	11.8	11.2		11.9	11.1		11.4			10.8			10.9			10.7
-Social contributions	14.6	15.4		14.8	15.0		15.4			16.4			16.9			17.1
-Other (residual)	7.7	6.2		7.4	7.4		7.1			7.9			7.5			7.3
<b>Expenditure</b>	51.4	51.0		51.2	50.7		49.8			50.4			50.8			50.7
<i>of which:</i>																
-Primary expenditure	49.2	48.4		49.3			47.8			48.5			49.0			48.9
<i>of which:</i>																
-Compensation of employees	10.0	10.1		10.0	9.7		9.8			9.6			9.8			9.7
-Intermediate consumption	8.3	8.2		8.1	7.8		7.6			7.6			7.5			7.5
-Social payments	22.6	23.6		23.1	22.8		23.2			23.7			24.6			24.8
-Subsidies	1.5	1.4		1.5	1.4		1.4			1.3			1.2			1.1
-Gross fixed capital formation	3.9	4.0		3.6	3.9		3.4			3.3			3.4			3.3
-Other (residual)	2.9	1.1		2.9	2.5		2.5			3.0			2.5			2.4
-Interest expenditure	2.2	2.6		1.9	2.5		2.0			1.8			1.8			1.8
<b>General government balance (GGB)</b>	-5.4	-6.1		-5.1	-5.6		-4.5			-4.1			-3.6			-3.6
<b>Primary balance</b>	-3.2	-3.7		-3.1	-3.1		-2.4			-2.2			-1.7			-1.7
One-off and other temporary measures	0	0		-0.2	0		-0.1			0.0			0.0			0.0
Structural balance	-4.1	-4.3		-4.0			-3.7			-2.6			-2.0			-2.3
change in structural balance		-0.2		0.1			0.4			1.0			0.7			-0.3
<b>Real GDP growth</b>	-3.9	0.3		1.7	1.6		1.0			-1.0			-0.8			0.9
<b>GDP deflator</b>	-0.2	1.0		1.3	1.4		1.2			0.7			1.4			1.7
<b>Nominal GDP</b>	572.0	564.4		588.4	599.2		602.0			606.6			604.5			620.0

Source: Commission services' 2009 Autumn Forecast (COM AF 09), Stability Programme 2013 (SP 13), AMECO

Table 2 shows the development of nominal government expenditure and revenue over the different forecast vintages since the Commission services' 2009 Autumn Forecast, including the forecast period up to and including 2014. Government expenditure for 2009 and 2010 turned out to be higher than initially forecast, but in 2011 was lower than in the EDP baseline scenario underlying the 2009 recommendation. Revenues on the other hand turned out to be much lower than expected in 2009, but higher than expected in 2010 and 2011. The table

shows that the widening of the deficit in 2009 was mainly on account of revenue falling well short of what was expected. In the outer years, the increase in nominal expenditure growth is expected to be lower than the increase in revenues (despite substantial revenue-increasing measures), illustrating the extent of restraint on the expenditure side committed to.

### 3.2. Assessment of effective action and budgetary implementation 2011-2013 and beyond - overview

The structural balance amounted to -4.0%, -3.7% and -2.6% of GDP in 2010, 2011 and 2012, respectively. The Commission services' 2013 Spring Forecast projects a further improvement in the structural balance to -2.0% of GDP in 2013 yet some subsequent deterioration to -2.3% in 2014 on unchanged policies. The average annual apparent fiscal effort over the period 2011-2013 is estimated at 0.7% of GDP. When adjusted for the downward revision in potential output growth since the time when the 2009 EDP recommendation was issued and the impact of the composition of economic growth on revenue, the average annual adjusted structural effort (1.1% of GDP) exceeds the recommended average annual fiscal effort (¾% of GDP) over 2011-2013 required in the 2009 Council EDP recommendation by a substantial margin (Table 3).

**Table 3 - Change in the structural balance corrected for revisions in potential**

Un-corrected average effort up until			Average effort corrected for $\alpha$ and $\beta$ until			Required fiscal effort in the 2009 recommendation	initial deadline for correction
2011	2012	2013	2011	2012	2013	2011-2013	
0.4	0.7	0.7		0.8	1.1	¾	2013

Source: Commission services' 2013 Spring Forecast and Commission services' calculations

A bottom-up approach from listing discretionary savings measures implemented and decided on from 2011 onwards confirms a very sizeable multi-annual consolidation effort. Table 4 reports the overall size of discretionary measures. The second-round impact of these measures on the macroeconomic developments has been fully taken into account in the Commission services' forecast<sup>2</sup>. For the period 2011-2013 the overall fiscal effort according to the bottom-up approach amounts to 4% of GDP, or around 1.3 % of GDP annually, broadly equally divided between revenue and expenditure measures.

**Table 4 - Composition of the budgetary adjustment**

Bottom-up approach to fiscal effort							
Measures (in % of GDP)	2011	2012	2013	2014	2015	2016	2017
<b>Expenditure</b>	-0.4	-0.7	-1.0	-0.9	-1.3	-0.5	-0.5
<b>Revenues</b>	0.1	0.1	1.7	0.0	-0.2	0.3	0.0
<b>Sum</b>	0.5	0.8	2.7	0.9	1.1	0.7	0.5

Source: Commission services calculations

Identified discretionary measures span a number of consecutive packages adopted over recent years. They include the phasing-out of the fiscal stimulus of 2010, including some additional measures taken (EUR 5 bn); an initial round of budgetary savings from September 2010

<sup>2</sup> The impact of the measures is broadly in line with the independent assessment carried out by the CPB (Tekortreducerende maatregelen 2011-2017, W. Suyker, <http://cpb.nl/publicatie/tekortreducerende-maatregelen-2011-2017>).

implemented by the first Rutte government (EUR 19 bn); measures embedded in the 'Kunduz' agreement of April 2012 (EUR 9 bn); and, finally, the coalition agreement of the second Rutte government outlined in September 2012 (EUR 15 bn). Table 4 shows that the brunt of the consolidation effort is centred on the year 2013, with a strong emphasis on net tax increases.

Table 5 reports the main budgetary measures over the period 2011-2013. In 2013, significant one-off operations will impact on the deficit. The sale of 4G mobile telephony licenses and the nationalisation of SNS Reaal (both impacting on 2013) broadly cancel out. On balance, however, one-offs have a decreasing impact on the deficit of around 0.2% of GDP, in particular related to dividend payments from the De Nederlandsche Bank and the restitution by Havenbedrijf Rotterdam of state contributions to port enlargement. Implementation of the measures in 2011 and 2012 proceeded as planned. The implementation of the budgets for both years was carried out without major slippages, which also confirms the robustness of the the fiscal framework in the Netherlands<sup>3</sup>. Also the implementation of the consolidation measures planned by previous governments for 2013 and beyond is on track.

Table 5: Main budgetary measures over 2011-2013	
Revenue	Expenditure
<b>2011</b>	
<ul style="list-style-type: none"> <li>Increase in the insurance tax (0.05 % of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>Wage moderation in the central government (-0.2 % of GDP)</li> <li>International cooperation (-0.1 % of GDP)</li> </ul>
<b>2012</b>	
<ul style="list-style-type: none"> <li>Limit on tax credit for single parents (0.1 % of GDP)</li> <li>Reversal of health care own contribution increase (0.1 % of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>Health care benefits (-0.1 % of GDP)</li> <li>Child care benefits (-0.1 % of GDP)</li> </ul>
<b>2013</b>	
<ul style="list-style-type: none"> <li>Adjustment treatment of pension deductability. (From 2013 onwards, fewer pension entitlements qualifying for tax relief can be accrued.) (0.1 % of GDP)</li> <li>VAT increase by 2 percentage points as of October 2012 (0.7 % of GDP)</li> <li>Environmental friendly taxation and increase in excise duty on alcohol, tobacco and soft drinks (0.25 % of GDP)</li> <li>Limiting mortgage interest deductibility for new mortgage loans (0 % of GDP; structural gains far beyond the programme horizon)</li> <li>Non-implementation of the <i>vitality package</i> (0.1 % of GDP)</li> </ul>	<ul style="list-style-type: none"> <li>Health care benefits (-0.1 % of GDP)</li> <li>Primary education (-0.1 % of GDP)</li> <li>Increase of own contribution for specialised health care in combination with other measures (-0.3 % of GDP)</li> <li>Increase retirement age (0 % of GDP, but sizeable structural gains beyond the programme horizon)</li> <li>Wage freeze (for civil servants and non-indexation of income tax brackets) (-0.5 % of GDP)</li> </ul>
<p><i>Note:</i> A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p>	

The measure-by-measure estimate of fiscal consolidation shows a broad congruity over the 2011-2013 assesment period over which effective action is assessed in response to the 2009

<sup>3</sup> In the fiscal framework of the Netherlands, every shortfall has to be compensated within the same expenditure ceiling or, if not possible, within another expenditure ceiling. Revenues are used as automatic stabilisers and are allowed to move freely unless the overall budgetary position is no longer in line with the SGP.

EDP recommendations. For 2011-2013, the two approaches yield a broadly comparable number for the average fiscal effort, in the range of 1.1. to 1.3% of GDP. This confirms the finding that the fiscal effort over the 2011-2013 assessment period is projected to substantially exceed the one recommended by the Council.

### **3.3. Budgetary outlook for 2014 and beyond**

Whereas the budgetary implementation in 2011-2013 by and large proceeded as planned and led to a significant improvement in the structural balance, achieving a correction of the excessive deficit by 2013 is clearly out of reach, even given the sizeable fiscal effort in the face of recession. The Commission services' 2013 Spring Forecast for 2014 only incorporates measures included in the Coalition Agreement and embedded in the budget laws as passed by Parliament and on this basis expects the headline general government balance to reach 3.6% of GDP in 2014.

The specified and agreed measures that are embedded in the multi-annual fiscal projections imply an ongoing consolidation in 2014. In addition, one-offs emanating from dividend streams from the De Nederlandsche Bank and a crisis levy on banks will have a downward effect on the headline deficit. Nonetheless, since revenue is expected to remain subdued in view of the sluggish recovery, the general government deficit is projected to stabilise at 3.6% of GDP in 2014. Discretionary measures of around 0.9% of GDP are planned to be implemented in 2014, fully on the expenditure side. The calculated change in the underlying balance from the macro (output-gap based) approach based on unchanged policies shows a slight worsening of the underlying fiscal position in 2014, by some 0.3% of GDP.

The Dutch authorities are strongly committed to correct the excessive deficit and, to this end, bring the headline deficit below 3% of GDP in 2014. However, the measures reported in the 2013 stability programme, though fully specified and quantified, fall short of reaching this goal<sup>4</sup>. Moreover, for the period beyond 2014 a sustainable adjustment as required by the EU fiscal surveillance framework does not appear to be assured on the basis of current policies. This implies that progress towards reaching the MTO would not be assured.

There are implementation risks attached to the measures incorporated in the Commission services' 2013 Spring Forecast 2013 and embedded in the medium-term budgetary plans. In the Netherlands, coalition agreements traditionally were implemented largely unchanged. Recently, there have been several examples of substantive changes, responding e.g. to the reappraisal of original plans by the coalition partners and the agreement between social partners. A different type of budgetary risk relates to the sizeable planned decentralisation measures. For example, parts of the budgets and responsibilities concerning youth and long-term care will be transferred to municipalities. This decentralisation process will include cutbacks on the respective budgets, on top of generic cuts on funds transferred to municipalities. It remains to be seen whether the implicitly planned efficiency gains can be realised and to what extent decentralisation may lead to increased deficits of subnational governments<sup>5</sup>. As long as any slippages remain limited, they can be compensated within the expenditure ceilings set. Nevertheless, more persistent deviations would have to be countered by fresh measures.

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<sup>4</sup> The SP mentions a set of possible further measures, initially announced by the government in March 2013, but these have been recently withdrawn by the government in reaction to the agreement among social partners – possibly to be considered again only in the summer if circumstance so require. These measures have not been taken into account in this assessment.

<sup>5</sup> The Netherlands is about to transpose the rules of the Fiscal Compact in its national legislation. This will make it easier for the central government to control deficits of subnational levels of government.



#### 4. PROPOSED NEW ADJUSTMENT PATH

According to the baseline macroeconomic scenario, which is the Commission services' 2013 Spring Forecast, on current policies the Netherlands is not forecast to correct its excessive deficit by the deadline established in the Council Recommendation of 2 December 2009 (Table 6). This is the case although the average annual adjusted structural effort for the period 2011-2013, taking account of the impact of revisions in potential output growth and of revisions of the revenue content of economic activity relative to the standard elasticities, is above the structural fiscal effort recommended by the Council. Moreover, over the adjustment period real and potential GDP will likely turn out to have been well below what was expected at the time that the 2009 EDP recommendation was issued. The unexpected adverse economic developments have entailed major unfavourable consequences for government finances. Considering all these factors and in particular the substantial deterioration in the budgetary position resulting from the weaker overall position of the economy relative to the one underlying the original Council recommendation under Article 126(7) TFEU suggests that a new deadline for the correction of the excessive deficit in the Netherlands by 2014 is appropriate.

**Table 6 - Forecast of key macroeconomic and budgetary variables under the baseline scenario**

<i>% of GDP</i>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Revenues	46.4	47.3	47.2
Current revenues	46.1	47.0	46.9
Discretionary measures with impact on current revenue	0.1	1.7	0.2
Expenditure	50.4	50.8	50.7
Real GDP growth (%)	-1.0	-0.8	0.9
Nominal GDP growth (%)	-0.2	0.6	2.6
Potential GDP growth (%)	0.2	0.0	0.3
Structural balance	-2.6	-2.0	-2.3
General government balance (%)	-4.1	-3.6	-3.6
<i>p.m CAB methodology revenue elasticity</i>	0.88	0.88	0.88
<i>p.m Apparent revenue elasticity</i>	-7.7	-1.6	0.8
<i>p.m Output gap (% of potential output)</i>	-2.5	-3.3	-2.7
<i>p.m nominal GDP</i>	600.6	604.5	620.0

Source: Commission services' 2013 Spring Forecast 2013

Granting an additional year for the correction of the excessive deficit would be commensurate with intermediate headline deficit targets of 3.6% of GDP for 2013 and 2.8% of GDP for 2014 (Table 7). The underlying improvement in the structural budget balance implied by these targets is 0.6% of GDP in 2013, and 0.7% of GDP in 2014. In total, to reach the above-mentioned structural targets, the Dutch authorities would need to implement additional consolidation measures of 0% of GDP in 2013 and at least 1% of GDP in 2014 on top of the measures already included in the baseline scenario. These targets take into account the need to compensate for the negative second-round effects of fiscal consolidation on public finances, through its impact on GDP growth.

**Table 7 - Forecast of key macroeconomic and budgetary variables under the EDP scenario**

<i>% of GDP</i>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Real GDP growth (%)	-1.0	-0.8	0.3
Potential GDP growth (%)	0.3	0.0	0.2
Structural balance	-2.6	-2.0	-1.3
General government balance (%)	-4.1	-3.6	-2.8
<i>p.m Output gap (% of potential output)</i>	-2.6	-3.4	-3.3
<i>p.m nominal GDP</i>	600.6	604.5	620.0

Source: Commission services

The economic crisis of the recent years has exposed weaknesses in the fiscal framework. Successive governments amended their medium-term budgetary plans with sizeable consolidation measures, also because initial expenditure ceilings had been based on growth paths which turned out to overly optimistic. According to the coalition agreement, automatic stabilisers are free to operate within each of the separate expenditure ceilings as long as the country's overall fiscal position remains in accordance with European fiscal rules. Interest payments are kept outside the overall expenditure ceiling, whereas other expenditure that is sensitive to cyclical trends (notably unemployment and social assistance benefits) is kept within the expenditure ceiling framework. This impedes the working of automatic stabilisers in an economic downturn. In addition, possible actions to operationalize the commitment to abide by European provisions are not specified in detail. The consolidation of public finances could be underpinned by making the medium-term orientation and institutional framework of public finances more binding and transparent, including through legislation that will transpose the EU fiscal rules into national legislation and by enshrining the medium-term budgetary framework in a legal basis.

## 5. CONCLUSIONS

On current information, the average annual fiscal effort after correction for the effects of revised potential output growth and revenue developments is estimated to amount to around 1.1% of GDP. The calculated adjusted structural effort is thus well above the required average annual fiscal effort of  $\frac{3}{4}$ % of GDP over 2010-2013 by the Council recommendation. A bottom-up approach confirms an average size of consolidation measures at some 1.3% of GDP over 2011-2013.

For 2013, the Dutch authorities have adopted a budget which contains significant measures which, however, do not suffice to achieve for the correction of the excessive deficit already in 2013, as recommended by the Council in 2009. This reflects the severe economic headwinds the Netherlands has been facing, translating into real and potential GDP growth falling well short of the path envisaged in the macro-economic scenario underlying the 2009 Council recommendation and implying severe adverse consequences for public finances. In light of this, a new deadline for the correction of the excessive deficit in the Netherlands by 2014 is appropriate, in line with the commitment by the authorities in the 2013 stability programme. To ensure this, a strict implementation of the 2013 budget target and additional measures in 2014 will be required.

Granting an additional year in the correction of the excessive deficit requires intermediate headline deficit targets of 3.6% of GDP for 2013 (3.8% of GDP without one-off measures) and 2.8% of GDP for 2014 (close to 3% without one-off measures). The underlying improvements in the structural budget balance implied by these targets are 0.6% in 2013 and 0.7% of GDP in 2014, in order to bring the headline general government deficit below the 3% of GDP reference value by 2014.

**Table 8: Comparison of key macroeconomic and budgetary projections**

		2009	2010	2011	2012	2013	2014
Real GDP (% change)	COM SF 13	-3.7	1.6	1.0	-1.0	-0.8	0.9
	COM AF 09	-4.5	0.3	1.6	NA	NA	NA
	SP 13	-3.7	1.6	1.0	-0.9	-0.4	1.1
Output Gap <sup>1</sup> (% of potential GDP)	COM SF 13	-2.7	-1.7	-1.4	-2.5	-3.3	-2.7
	COM AF 09	-2.7	-3.1	-2.4	NA	NA	NA
	SP 13	-2.7	-1.7	-1.6	-2.8	-3.5	-3.0
Potential growth	COM SF 13	1.0	0.6	0.7	0.2	0.0	0.3
	COM AF 09	1.1	0.7	0.9	NA	NA	NA
	SP 13	1.0	0.6	0.9	0.3	0.3	0.6
General government balance (% of GDP)	COM SF 13	-5.6	-5.1	-4.5	-4.1	-3.6	-3.6
	COM AF 09	-4.7	-6.1	-5.6	NA	NA	NA
	SP 13	-5.6	-5.1	-4.5	-4.1	-3.4	-3.0
Primary balance (% of GDP)	COM SF 13	-3.4	-3.1	-2.4	-2.2	-1.7	-1.7
	COM AF 09	-2.3	-3.7	-3.1	NA	NA	NA
	SP 13	-3.4	-3.1	-2.0	-0.9	0.2	0.3
Cyclically-adjusted balance <sup>1</sup> (% of GDP)	COM SF 13	-4.1	-4.2	-3.7	-2.6	-1.8	-2.0
	COM AF 09	-3.2	-4.4	-4.3	NA	NA	NA
	SP 13	-4.1	-4.2	-3.6	-2.4	-1.4	-1.2
Structural balance <sup>2</sup> (% of GDP)	COM SF 13	-4.1	-4.0	-3.7	-2.6	-2.0	-2.3
	COM AF 09	-3.6	-4.4	-4.3	NA	NA	NA
	SP 13	-4.1	-4.0	-3.6	-2.4	-1.5	-1.4
Government gross debt (% of GDP)	COM SF 13	60.8	63.1	65.5	71.2	74.6	75.8
	COM AF 09	59.8	65.6	69.7	NA	NA	NA
	SP 13	60.8	63.1	65.5	71.2	74.0	75.0

**Note:**

<sup>1</sup> Output gaps and cyclically-adjusted balances according to the information provided in the programmes.

<sup>2</sup> Cyclically-adjusted balance excluding one-off and other temporary measures.

*Source: Commission services' 2013 Spring Forecast (COM SF 13), Commission services' 2009 Autumn Forecast (COM AF 09), and April 2010 update of the stability programme (SP 10)*