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Analysis of the 2016 Draft Budgetary Plan of THE NETHERLANDS

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of THE NETHERLANDS

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1. INTRODUCTION

The Netherlands submitted its Draft Budgetary Plan (DBP) for 2016 on 9 October 2015 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. The Netherlands is subject to the preventive arm of the Pact and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective (MTO).

As the general government gross debt ratio was 67.9% of GDP in 2013 (the year in which the Netherlands corrected its excessive deficit), during the three years following the correction of the excessive deficit the Netherlands is also subject to the transitional debt rule. In this period it should ensure sufficient progress towards compliance.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission Forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2015 autumn forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2015-2016 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact (SGP). Section 5 provides an analysis of implementation of reforms in the area of fiscal governance in response to the latest Country-specific Recommendations (CSRs) adopted by the Council on 14 July 2015, including those to reduce the tax wedge. Section 6 concludes.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic projections underlying the DBP are based on the updated forecast of the Netherlands Bureau of Economic Policy (CPB) (see Box 1). Following real GDP growth of 1.0% in 2014, the DBP expects output growth to accelerate to 2.0% in 2015 and to pick up further to 2.4% in 2016. A broad-based economic expansion is expected, supported by a recovery in domestic demand as well as a positive influence of net trade on economic growth in 2015 and 2016.

Compared to the 2015 Stability Programme of the Netherlands, this forecast represents a moderate upward revision of the growth outlook. This is mainly explained by a better-than-expected quarterly GDP growth trajectory in the first half of 2015, as well as by the impact of a newly-announced €5bn (0.7% of GDP) policy package designed to support disposable income and lower the tax wedge in 2016. The Commission 2015 autumn forecast also expects GDP growth of 2.0% in 2015, whereas it anticipates growth of 2.1% in 2016, i.e. somewhat lower than expected in the DBP. This difference stems primarily from net external demand making a marginally negative growth contribution in 2016 in the Commission forecast, as opposed to a slightly supportive one in the DBP.

The DBP anticipates the economic recovery to be accompanied by an improving labour market. HICP inflation is expected to pick up from a low rate in 2015 to 1.1% in 2016. Overall, these projections broadly match the Commission 2015 autumn forecast, which incorporates somewhat stronger employment growth and weaker inflation in 2015, with the latter partly due to the Commission's weaker oil price assumptions.

The largest risk to the macroeconomic forecast underlying the DBP is external in nature, as the outlook assumes a marked acceleration of export market growth in 2016, compared with the limited rise expected in the Commission 2015 autumn forecast. Overall, the DBP's macroeconomic assumptions are plausible in 2015 and favourable thereafter.

Box 1: The macro economic forecast underpinning the budget in the Netherlands

The macroeconomic forecast underpinning the draft budget for 2016 was produced by the Bureau for Economic Policy Analysis (CPB). The CPB is functionally attached to and mainly financed by the Ministry of Economic Affairs. It enjoys full operational freedom formally guaranteed by law[1], and manages significant own resources.

The government traditionally uses the CPB's macroeconomic forecast to present the budgetary and economic effects of planned measures. This established practice has been formalised in 2013 by virtue of the Law on the Sustainability of Public Finances (*Wet houdbare overheidsfinanciën, or Wet HOF*).

The government is nonetheless allowed to diverge from the CPB's own budgetary forecast. In the draft budget for 2016 the government has exercised this right and has forecast general government budget deficits for 2015 and 2016 that are 0.1pp higher than the CPB estimate.

[1] The law *Wet houdende de voorbereiding van de vaststelling van een Centraal Economisch Plan* from 1947 gives the CPB the legal basis for its operations. The law *Aanwijzing op de Planbureaus* from 2012 codifies the independence of the CPB.

Table 1. Comparison of macroeconomic developments and forecasts

	2014	2015			2016		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	1.0	1.7	2.0	2.0	1.8	2.4	2.1
Private consumption (% change)	0.0	1.5	1.6	1.7	1.7	1.9	2.1
Gross fixed capital formation (% change)	3.5	3.4	7.4	8.8	3.9	5.4	4.7
Exports of goods and services (% change)	4.0	4.6	3.7	4.6	4.8	5.1	4.1
Imports of goods and services (% change)	4.0	4.9	4.1	5.2	5.3	5.7	4.8
Contributions to real GDP growth:							
- Final domestic demand	0.7	1.3	1.9	2.3	1.4	2.0	2.0
- Change in inventories	-0.1	0.1	-0.2	-0.4	0.1	0.1	0.2
- Net exports	0.5	0.2	0.2	0.1	0.2	0.2	-0.1
Output gap[1]	-2.7	-2.1	-1.6	-1.6	-1.1	-0.3	-0.5
Employment (% change)	-0.2	0.9	0.7	1.1	1.0	1.1	1.0
Unemployment rate (%)	7.4	7.2	6.9	6.9	7.0	6.7	6.6
Labour productivity (% change)	1.3	0.8	1.3	0.9	0.9	1.3	1.0
HICP inflation (%)	0.3	-0.1	0.5	0.2	0.9	1.1	1.2
GDP deflator (% change)	0.8	1.0	0.8	0.9	0.8	1.0	1.5
Comp. of employees (per head, % change)	2.2	0.5	0.9	0.8	2.3	2.5	1.7
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	10.7	10.0	10.9	10.6	9.5	10.7	10.7

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:
Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3. Recent and planned fiscal developments

3.1. Deficit developments

The projected general government balance for 2015 of the DBP shows a deficit of 2.2% of GDP, which is somewhat higher than was projected in the 2015 Stability programme (by 0.4% of GDP), and comes in spite of a better-than-anticipated growth outturn in the first half of 2015. Most of the difference is explained by government decisions to successively reduce gas production levels in 2015 and beyond due to safety concerns, with a corresponding negative impact on fiscal revenues and the headline balance. The government deficit for 2015 is broadly in line with the Commission 2015 autumn forecast.

Compared to the Stability Programme, the projected general government deficit for 2016 was revised upwards in the DBP by 0.3% of GDP to 1.5%. Both revenue and expenditure levels as a share of GDP are lower in the DBP, partly due to the denominator effect stemming from faster growth in 2015 and 2016. The total revenue ratio in 2016 is also lowered by a newly-announced package of measures aimed at reducing the tax burden on labour from 2016 onwards. Of this €5bn (0.7% of GDP) package, €4.7bn worth of measures operate via the revenue side and are dedicated to reducing the tax burden, while €0.3bn are linked to higher expenditure.

The Commission 2015 autumn forecast expects a general government budget deficit in 2016 of 1.5% of GDP, in line with the DBP. By contrast, overall expenditure and revenue ratios are both somewhat lower in the Commission forecast. This is partly explained by a denominator effect from a higher 2016 nominal GDP level in the Commission forecast, as well as by lower receipts from social contributions in the Commission forecast on the revenue side. The Commission forecast expects a lower overall primary expenditure ratio, in part explained by lower social expenditures. Risks to these projections appear broadly balanced; stronger-than-expected domestic demand could generate additional revenues in 2016, while unexpected refugee-related costs might increase expenditure somewhat.

The (recalculated)[2] structural balance of the DBP shows a more limited deterioration in 2016 than the Commission 2015 autumn forecast. This is due to the fact that in its calculations of the structural balance the Commission forecast excludes as a one-off measure an anticipated €1.8bn (0.3% of GDP) refund to the Netherlands in 2016 resulting from the implementation of the Own Resources Decision 2014 (ORD14).

Ex-ante compliance of the budget plan with the numerical fiscal rules was assessed by the Advisory Division of the Council of State (CoS-AD), based on a mandate granted by the Wet HOF. The CoS is a public body that is constitutionally independent from the government. In its report published on 14 September 2015, the CoS acknowledges that the debt and expenditure rules as defined in the SGP are complied with in the budget plan for 2016 (and for 2015 as well). Regarding the compliance with the MTO of -0.5%, the CoS-AD assesses that the structural balance deviates in 2015 and 2016. It concludes that the marked structural balance deterioration in 2015 and 2016 will make the preparation of the 2017 budget more difficult.

[2] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the Draft Budgetary Plan, using the commonly agreed methodology.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2014	2015			2016			Change: 2014-2016
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**43.9**	**43.8**	***42.9***	**42.6**	**44.0**	***42.7***	**41.8**	**-1.2**
of which:								
- Taxes on production and imports	11.3	11.2	*11.1*	11.1	11.2	*11.2*	11.1	-0.1
- Current taxes on income, wealth, etc.	10.7	11.6	*11.3*	11.0	11.5	*10.9*	10.6	0.2
- Capital taxes	0.2	0.2	*0.2*	0.2	0.2	*0.2*	0.2	0.0
- Social contributions	15.4	14.6	*14.5*	14.4	15.1	*14.9*	14.3	-0.5
- Other (residual)	6.3	6.2	*5.8*	5.9	6.0	*5.5*	5.5	-0.8
Expenditure	**46.2**	**45.6**	**45.0**	**44.7**	**45.2**	**44.1**	**43.3**	**-2.1**
of which:								
- Primary expenditure	44.8	44.3	43.7	43.4	44.0	42.9	42.0	-1.9
of which:								
Compensation of employees	9.2	8.9	9.1	9.0	8.9	8.9	8.8	-0.3
Intermediate consumption	6.3	6.0	5.7	6.0	5.9	5.6	6.2	-0.7
Social payments	22.1	21.9	21.6	21.6	21.7	21.4	21.0	-0.7
Subsidies	1.2	1.2	1.2	1.2	1.2	1.2	1.2	0.0
Gross fixed capital formation	3.5	3.5	3.3	3.3	3.4	3.2	3.1	-0.3
Other (residual)	2.5	2.8	2.8	2.3	2.9	2.6	1.8	0.1
- Interest expenditure	1.4	1.3	1.3	1.3	1.2	1.2	1.2	-0.2
General government balance (GGB)	**-2.4**	**-1.8**	**-2.2**	**-2.1**	**-1.2**	**-1.5**	**-1.5**	**0.9**
Primary balance	**-0.9**	**-0.5**	**-0.9**	**-0.8**	**0.1**	**-0.3**	**-0.3**	**0.6**
One-off and other temporary measures	-0.1	0.0	0.0	0.0	0.0	0.0	0.3	0.1
GGB excl. one-offs	**-2.3**	**-1.8**	**-2.2**	**-2.1**	**-1.2**	**-1.5**	**-1.8**	**0.8**
Output gap[1]	-2.7	-2.1	-1.6	-1.6	-1.1	-0.3	-0.5	2.4
Cyclically-adjusted balance[1]	-0.6	-0.5	-1.2	-1.1	-0.4	-1.3	-1.1	-0.7
Structural balance (SB)[2]	**-0.5**	**-0.5**	**-1.2**	**-1.1**	**-0.4**	**-1.3**	**-1.4**	**-0.8**
Structural primary balance[2]	0.9	0.8	0.1	0.3	0.8	-0.1	-0.2	-1.0

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

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

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

Box 2: Impact of the current low interest rate environment on compliance with the SGP

Identifying an interest rate windfall/shortfall for 2016

Sovereign bond yields have fallen sharply since end-2013 and reached historical lows in the first half of 2015, before increasing somewhat during the summer months. However, yields in the Netherlands still remain well below their long-term average of 4.1%, with 10-year rates standing at 0.67%. As a result of lower interest rates, total interest payments by the general government have also decreased over the last few years. Interest expenditure in the Netherlands is expected to fall from 1.6% of GDP in 2012 to 1.3% in 2015, and is projected to decrease further next year, to 1.2% of GDP in 2016, based on the information provided in the DBP, in line with the Commission forecast.

Prospects and vulnerability

Over the 2016-18 period, 35% of the Netherlands' outstanding government bond debt is due to be refinanced. While this offers considerable scope for bond rollovers at significantly lower yields, the potential interest savings are limited by the comparatively moderate level of government bond debt (around 54% of GDP) as well as by the typically low sovereign credit spread over AAA-rated benchmark rates.

Consequences for public finances

Comparing the interest expenditure projections across different vintages of Stability and Convergence Programmes and the DBP sheds more light on the (unexpected) interest windfall since the fall in interest rates (see Chart)[3].

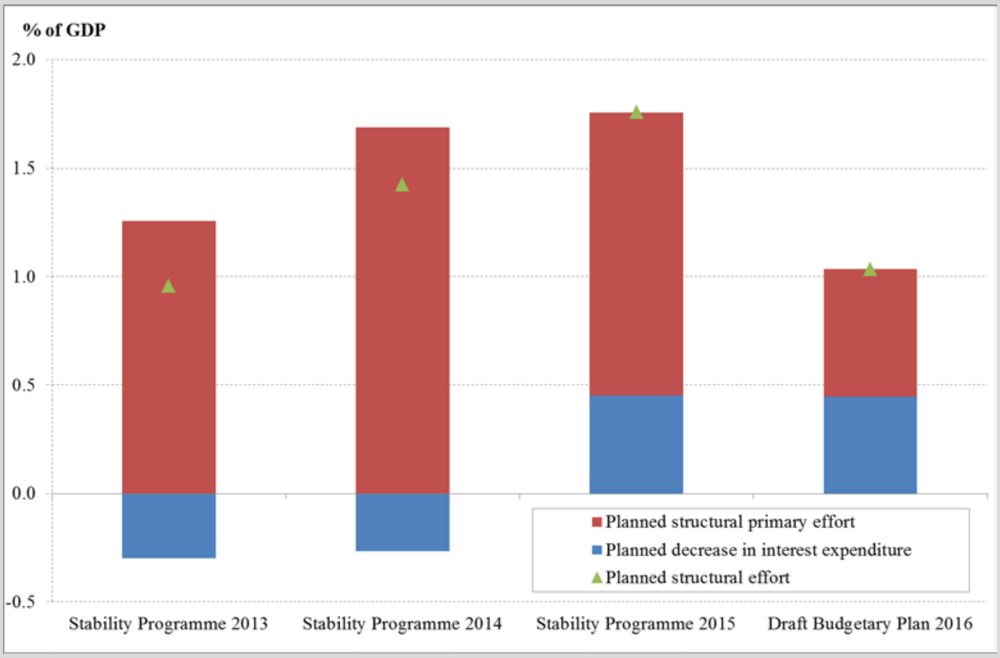
While the cumulative structural primary effort for the 2012-16 period has shrunk over the course of recent vintages of the Netherlands' budgetary plans, interest expenditure savings have come to account for an increasingly large portion of the overall fiscal effort. In the Stability Programme 2014, the cumulative structural primary effort for the 2012-16 period amounted to 1.7% of GDP, which has fallen to 0.6% of GDP in the DBP 2016. At the same time, the reversal in the outlook for interest expenditure has caused an interest expenditure windfall of 0.7% of GDP between the Stability Programme 2014 and the DBP 2016. As a result, almost half of the total structural effort of 1.0% of GDP in the 2012-16 period is now accounted for by a planned decrease in interest expenditure (0.4% of GDP), according to information provided in the latest DBP 2016.

Furthermore, based on the Commission 2015 autumn forecast, the structural primary effort in the 2012-16 period would be even smaller (0.3% of GDP), as the structural balance calculations exclude as a one-off the refund to the Netherlands in 2016 linked to the ORD14 . This would suggest that the planned structural effort of the Netherlands between 2012 and 2016 relies predominantly on interest rate windfalls.

However, the impact of low interest rates on fiscal balances cannot be analysed in isolation from wider inflation and macroeconomic developments. Especially the positive macroeconomic impact of low inflation on real disposable income and real spending activity should be noted. While this should cause favourable multiplier effects on overall output growth, the contractionary impact of lower inflation on growth in the (nominal) tax base would counteract the real expenditure boost on the tax base and tax receipts. Equally, the support to tax revenue growth from fiscal drag also becomes less pronounced in a low-inflation scenario. Given the importance of low energy prices in driving down inflation, and in light of the Netherlands' role as a natural gas producer, the overall impact of low inflation on the public finances may not be straightforward.

[3] Note that, while it is likely that revisions in the interest expenditure projections across different vintages primarily reflect changes in interest rates, other factors such as debt dynamics, the maturity profile of debt and statistical reclassifications (e.g. the switchover to the ESA 2010 standard of national accounts) may also have played a role.

Structural effort and decrease in interest expenditures between 2012 and 2016 based on government plans



Source: Stability programmes, Draft Budgetary Plan 2016 and AMECO

3.2. Debt developments

The DBP expects government debt to fall slightly over the forecast horizon and reach 66.2% of GDP in 2016.

The debt trajectory is somewhat more favourable than was expected in the 2015 Stability Programme. The difference stems largely from divergent stock-flow adjustments. The DBP includes a significantly more favourable stock-flow adjustment in 2015 than the 2015 Stability Programme. One important difference is a more favourable trajectory for the net accumulation of financial assets in 2015; however, the DBP provides no further information as to their origin. By contrast, debt developments in 2016 follow broadly the same downward trajectory in the DBP and Stability Programme, with more favourable nominal growth dynamics in the former largely making up for the less favourable primary balance in 2016.

Compared to the DBP, the Commission 2015 autumn forecast shows a more modest decline in the government debt ratio. This is in principally due to differences in stock-flow adjustments, which the Commission forecast expects to be broadly neutral in their impact on the debt ratio. Given the opaque nature of stock-flow adjustments, their favourable role in shaping the debt trajectory of the DBP constitutes a negative risk factor to the debt evolution expected in the plan.

Table 3. Debt developments

(% of GDP)	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**68.2**	**68.8**	**67.2**	**68.6**	**67.8**	**66.2**	**67.9**
Change in the ratio	0.3	0.6	-1.0	0.4	-1.0	-1.0	-0.6
Contributions[2] *:*							
1. Primary balance	**0.9**	**0.5**	**0.9**	**0.8**	**-0.1**	**0.3**	**0.3**
2. "Snow-ball" effect	**0.2**	**-0.5**	**-0.5**	**-0.6**	**-0.6**	**-0.9**	**-1.2**
Of which:							
Interest expenditure	1.4	1.3	1.3	1.3	1.2	1.2	1.2
Growth effect	-0.7	-1.1	-1.3	-1.4	-1.2	-1.6	-1.4
Inflation effect	-0.5	-0.7	-0.5	-0.6	-0.6	-0.6	-1.0
3. Stock-flow adjustment	**-0.9**	**0.6**	**-1.3**	**0.2**	**-0.3**	**-0.4**	**0.3**
Of which:[3]							
Cash/accruals difference		0.0	-0.1		0.2	0.1	
Net accum. of fin. assets		-0.1	-1.0		-0.5	-0.3	
of which privatisation proceeds		0.0	0.0		0.0	0.0	
Valuation effect & residual		-1.8	-1.8		-1.8	-2.2	

Notes:

[1] End of period.

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

[3] Stock-flow adjustment contributions do not sum to the total due to definitional differences between Commission and national authorities' calculations

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the Draft Budgetary Plan

To a large extent, both expenditure and revenue developments over the horizon of the DBP are determined by broader macroeconomic developments, as well as by pre-existing, multi-annual expenditure and revenue plans, in keeping with the Dutch national fiscal framework. Discretionary policy measures presented in the DBP are reflected in Tables 4a and 4b. On the revenue side, discretionary policy changes presented in the DBP are relatively large and include €4.7bn worth of measures making up the €5bn (0.7% of GDP) policy package to reduction in the tax burden on labour from 2016 onwards. The package's negative impact on overall revenues is partly compensated by the fact that various pre-planned revenue increases will also take place in 2016, which are already incorporated into the baseline path of the 2016 budget. All the aforementioned measures have also been incorporated into the Commission 2015 autumn forecast.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2015	**2016**	**2017**
Taxes on production and	0.0	0.0	-0.1
Current taxes on income,	0.0	-0.7	-0.6
Capital taxes	0.0	0.0	0.0
Social contributions	0.0	0.0	0.0
Property Income	0.0	0.0	0.0
Other	0.0	0.0	0.0
Total	0.0	-0.7	-0.7

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2016

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)		
	2015	**2016**	**2017**
Compensation of employees	0.0	0.1	0.1
Intermediate consumption	0.0	0.0	0.0
Social payments	0.1	0.0	0.0
Interest Expenditure	0.0	0.0	0.0
Subsidies	0.0	0.0	0.0
Gross fixed capital	0.0	0.0	0.0
Capital transfers	0.0	0.0	0.0
Other	0.1	-0.1	0.0
Total	0.2	0.0	0.1

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source: Draft Budgetary Plan for 2016

On the expenditure side, the DBP includes small expenditure-increasing discretionary measures for 2015 and 2017. The single largest item on the expenditure side is the shifting back to 2016 of the 0.3% of GDP refund to the Netherlands from EC budget contributions for 2014 and 2015 following the ratification of ORD14. Both the timing and the size of this negative expenditure thereby correspond to the Commission's autumn 2015 forecast assumptions; however the Commission forecast records it as a one-off measure, in contrast to the DBP (see section 3.1).

While the estimated budgetary impact of the DBP's measures appears generally plausible, there appear to be risks of higher-than-anticipated expenditure on refugees, as the estimated arrival numbers in 2016 underlying the Budget appear low compared to trends that have become apparent since the early summer.

The DBP measures reflected in Table 4a and 4b do not appear to contribute significantly to meeting the fiscally-related CSRs, even though there is some policy progress being made in addressing existing taxation and pensions challenges (see section 5).

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

The Netherlands is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. The Netherlands is also subject to the transitional debt rule. Box 3 reports the latest country specific recommendations in the area of public finances.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2013, the Netherlands is in the transition period as regards the debt criterion for the following three years. This implies that, during this period, it is required to make sufficient progress towards compliance with the debt criterion (as defined by the minimum linear structural adjustment (MLSA) and to comply with the debt benchmark at the end of the transition period.

The DBP does not provide sufficient information to assess compliance with the MLSA. Based on the Commission 2015 autumn forecast the Netherlands is making sufficient progress towards complying with the debt rule in both 2015 and 2016, as the projected changes in the structural balance (-0.5% and -0.3% of GDP respectively) are above the requirements (-0.7% and -1.0% of GDP respectively) (Table 5). As indicated in section 3.2, risks to the debt projections (and compliance with the debt benchmark) appear small and are limited to the role of stock-flow adjustments in lowering the debt trajectory.

Table 5. Compliance with the debt criterion*

	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	68.2	68.8	67.2	68.6	67.8	66.2	67.9
Gap to the debt benchmark [1,2]							
Structural adjustment [3]	0.4	-0.3	-0.6	-0.5	0.0	-0.1	-0.3
To be compared to:							
Required adjustment [4]	n.a.	-2.2	n.a.	-0.7	-4.1	n.a.	-1.0

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:
Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

* An ex-ante assessment of planned compliance with the debt criterion can be based on the DBP only for the concerned countries providing extended data series (i.e. covering years up to t+4) in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September 2014 and reflected in the updated Code of Conduct of the two-pack..

4.2. Compliance with the MTO

According to the Commission 2015 spring forecast, the Netherlands was above its MTO in 2014 with a structural balance of -0.2% of GDP. Accordingly, it has to maintain its structural balance at the MTO in the years thereafter and respect the expenditure benchmark.

The DBP shows a deterioration in the (recalculated) structural balance of 0.6% of GDP in 2015, which represents some deviation (-0.4% of GDP) from the requirement. On the other hand, according to the information provided in the DBP, the growth rate of government expenditure, net of discretionary revenue measures, in 2015 will not exceed the applicable benchmark rate of 1.4%. This requires an overall assessment, which notes revenue shortfalls caused by low gas production revenues in 2015 and beyond. Furthermore, the highly-indebted Dutch household sector is only slowly emerging from a long deleveraging phase, which will still weigh on consumption and associated tax revenues. For these two reasons the expenditure benchmark appears to be a better indicator of the fiscal effort at the current juncture, thus pointing to compliance based on the DBP. Similarly, the Commission 2015 autumn forecast also shows some deviation from the requirement in 2015, while also suggesting that the expenditure benchmark is met in 2015. This therefore requires an overall assessment, which – on the same grounds – favours reliance on the expenditure benchmark and therefore points to compliance in 2015.

Table 6: Compliance with the requirements of the preventive arm

(% of GDP)	2014	2015		2016	
Initial position[1]					
Medium-term objective (MTO)	-0.5	-0.5		-0.5	
Structural balance[2] (COM)	-0.5	-1.1		-1.4	
Structural balance based on freezing (COM)	-0.2	-0.3		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2014**	**2015**		**2016**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.0		0.0	
Required adjustment corrected[5]	0.1	-0.3		-0.2	
Change in structural balance[6]	0.4	-0.6	-0.5	-0.1	-0.3
One-year deviation from the required adjustment [7]	0.3	-0.4	-0.3	0.1	-0.2
Two-year average deviation from the required adjustment [7]	n.a. (in EDP in 2013)	0.0	0.0	-0.2	-0.2
Expenditure benchmark pillar					
Applicable reference rate[8]	0.7	1.4		1.2	
One-year deviation [9]	0.3	0.7	0.9	0.5	0.6
Two-year average deviation [9]	n.a. (in EDP in 2013)	0.5	0.6	0.6	0.8
Conclusion					
Conclusion over one year	Compliance	Overall assessment	Overall assessment	Compliance	Overall assessment
Conclusion over two years	n.a. (in EDP in 2013)	Compliance	Compliance	Overall assessment	Overall assessment

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 27.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations.

In 2016 the (recalculated) structural balance of the DBP respects the requirement, and the expenditure benchmark rate of 1.2% is also respected in that year. However, the structural balance deviation in 2015 causes some deviation in the two-year average of the (recalculated) structural balance of the DBP for 2015 and 2016. This calls for an overall assessment, which finds that revenue shortfalls continue to explain the deviation on the structural balance pillar, given ongoing weakness of gas production revenues and household deleveraging. As was the case for 2015, this favours the expenditure benchmark, which would indicate compliance in 2016 on basis of the DBP. Based on the Commission 2015 autumn forecast, the projected 0.3% of GDP deterioration in the structural balance[4] points to some deviation from the requirement. By contrast, the expenditure benchmark is expected to be met. This calls for an overall assessment. The difference between the two indicators stems again from a temporary revenue shortfall based on the same factors as mentioned above (low gas revenues and household deleveraging). Considering these factors the expenditure benchmark appears to be a better indicator of the fiscal effort at the current juncture. Therefore, the overall assessment points to compliance with the MTO in 2016.

Following an overall assessment of the Member State’s DBP, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures the adjustment path towards the MTO seems to be appropriate and compliant with the requirement of the preventive arm of the Pact in 2015 and 2016.

5. IMPLEMENTATION OF REFORMS IN THE AREA OF FISCAL GOVERNANCE

The DBP contains information on the fiscal governance reforms recommended by the CSRs of 14 July 2015 that is assessed in this section. It provides details on the measures planned and taken to address the Netherlands' CSRs and ensure achievement of the Europe 2020 targets. While many of the measures were known at the time of the 2015 Stability Programme and the 2015 National Reform Programme, there appears to have been further progress in some relevant policy areas.

Box 3. Council recommendations addressed to the Netherlands

On 14 July 2015, the Council addressed recommendations to the Netherlands in the context of the European Semester. In particular, in the area of public finances the Council recommended to the Netherlands to "*shift public expenditure towards supporting investment in R & D and work on framework conditions for improving private R & D expenditure in order to counter the declining trend in public R & D expenditure and increase the potential for economic growth.*"

To comply with the recommendation on public finances, which calls for shifting public expenditure towards R&D investment, a new Regulation provides for €40m in research credits, while the application procedure for an R&D tax rebate will be streamlined.

A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the CSRs adopted by the Commission in May.

[4] The higher deterioration in the structural balance in 2016 in the Commission forecast compared to the DBP is due to the exclusion of a one-off measure in 2016 related to the implementation of the 2014 Own Resources Decision.

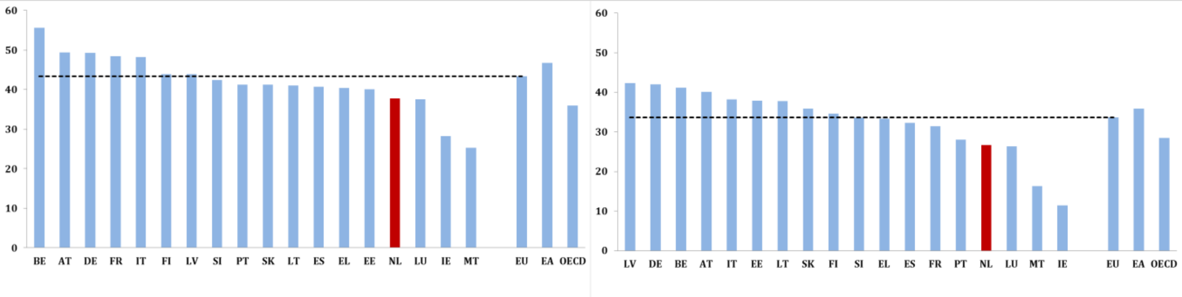
Box 4: Addressing the tax burden on labour in the euro area

Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to screen euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability. Furthermore, the Eurogroup expressed its intention to take stock of the state of play in the reduction of the tax burden on labour when discussing the DBPs of euro area Member States.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker’s net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in the Netherlands for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in the Netherlands at the average wage and a low wage (2014)



Notes: Data for Latvia, Lithuania and Malta is for 2013. No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted. These graphs represent only the tax wedge on labour; compulsory health care and pension contributions, which in the case of the Netherlands account for a relatively large part of the burden on labour, are not included.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

This screening is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

As part of the €5bn (0.7% of GDP) package of policy measures for 2016, the DBP contains (amongst other items) the following measures to reduce lower the tax wedge on labour:

- An increase of the employed person's tax credit for earnings up to about €50,000 to a maximum of €638 (total budgetary cost: € 2.6 billion; 0.4% of GDP).

- A reduction of the tax rates in the second and third tax bracket by approximately 1.85pps (budgetary cost: € 2.6 billion; 0.4% of GDP).

- A raising of the threshold for the top income tax rate; above this threshold, people pay the top rate of 52% (budgetary cost: € 0.8 billion; 0.1% of GDP).

- Raising the income-related combination tax credit for parents (IACK), costing an extra €0.3 billion.

- These measures are partly financed by a full phasing-out of the general tax credit (revenue yield of € 2.1 billion).

The €5bn package of measures is reflected in the Commission 2015 autumn forecast and is expected to be implemented in 2016. It targets the active population and is intended to stimulate economic activity. The DBP cites a CPB estimate of the employment impact of the €5bn policy package, which is expected to create 35,000 additional jobs in the longer term.

6. OVERALL CONCLUSION

Based on the Commission 2015 autumn forecast, the Netherlands is making sufficient progress towards complying with the debt rule in 2015 and 2016.

Following an overall assessment of the Netherlands' DBP for 2016, the country's structural balance is expected to be in line with the MTO in 2015 and 2016. This assessment is confirmed based on the Commission 2015 autumn forecast.