COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 23 January 2008
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Recommendation for a

COUNCIL OPINION

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

On the updated stability programme of the Netherlands, 2007-2010

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL BACKGROUND

The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation. The 2005 reform of the Pact acknowledged its usefulness in anchoring fiscal discipline but sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run.

Council Regulation (EC) No 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], which is part of the Stability and Growth Pact, stipulates that each Member State has to submit, to the Council and the Commission, a stability or convergence programme and annual updates thereof. Member States that have already adopted the single currency submit (updated) stability programmes and Member States that have not yet adopted it submit (updated) convergence programmes. The first stability programme of the Netherlands was submitted in November 1998. In accordance with the Regulation, the Council delivered an opinion on it on 1 December 1999 on the basis of a recommendation from the Commission and after having consulted the Economic and Financial Committee. As regards updated stability and convergence programmes, the regulation foresees that these are assessed by the Commission and examined by the Committee and if necessary and following the same procedure as set out above, they may be examined by the Council.

2. BACKGROUND FOR THE ASSESSMENT OF THE UPDATED PROGRAMME

The Commission has examined the most recent update of the stability programme of the Netherlands, submitted on 29 November 2007, and is recommending a Council opinion on it (see box for the main points covered by the assessment).

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

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

(2) the orientations for budgetary policies adopted by the April 2007 Eurogroup,

(3) the March 2007 update of the country-specific broad economic policy guidelines in the area of budgetary policies, and

(4) the Commission's assessment of the October 2007 implementation report of the national reform programme.

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1 OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text are available at: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

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

In its opinion of 27 February 2007, the Council summarised its assessment of the previous update of the stability programme, covering the period 2006-2009, as follows.

"The Council considers that the medium-term budgetary position is sound and the budgetary strategy provides an example of fiscal policies conducted in compliance with the Stability and Growth Pact. Nevertheless, an important risk is that the current high level of gas receipts may not persist but overall the risks attached to the achievement of the budgetary targets are broadly neutral". In view of its assessment and the good growth prospects, the Council invited the Netherlands to "maintain a strong structural position in 2007 and beyond, thereby avoiding pro-cyclical fiscal policies in good times".

2.2. Orientations for budgetary policies adopted by the Eurogroup in April 2007

On 20 April 2007, with a view to improving the coordination of fiscal policies in the euro area, Eurogroup ministers discussed national budgetary developments in 2007 and the preliminary policy outlook for 2008 and their implications for the euro area.

Reaffirming their adherence to the sound fiscal policy principles of the revised Stability and Growth Pact and to national fiscal rules, Ministers committed to (i) build on the better-than-expected budgetary outcomes in 2006 to pursue more ambitious budgetary targets than those set in the end-2006 updates of the stability programmes; (ii) implement their 2007 budgets as planned, avoiding expenditure overruns, and using unexpected extra revenues to reduce government deficit and debt; and (iii) carefully design fiscal policy plans for 2008 so as to accelerate the adjustment towards the MTO for Member States which have not reached it and for those which have reached it to avoid feeding macroeconomic imbalances overall[2].

2.3. March 2007 update of the country-specific broad economic policy guidelines in the area of budgetary policies

On 27 March 2007, the Council adopted in the context of the Lisbon strategy a recommendation on the 2007 update of the broad guidelines for the economic policies of the Member States and the Community and on the implementation of Member States' employment policies[3]. The Netherlands was not recommended to take particular action in the area of budgetary policies. However, all euro area Member States were recommended to “make use of the favourable cyclical conditions to aim at or pursue ambitious budgetary consolidation towards their medium-term objectives in line with the Stability and Growth Pact, hence striving to achieve an annual structural adjustment of at least 0.5 % of GDP as a benchmark” and “to improve the quality of public finance by reviewing public expenditures and taxation, with the intention to enhance productivity and innovation, thereby contributing to economic growth and fiscal sustainability”.

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2 The entire statement can be found at: www.gouvernement.lu/salle_presse/actualite/2007/04/20pm_krecke_berlin/MTBR_EG_conclusions-finalCLEAN.rtf

3 OJ L 92, 3.4.2007, p. 23.

2.4. The Commission assessment of the October 2007 implementation report of the national reform programme

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which included an assessment of the October 2007 implementation report of Dutch national reform programme[4]. This can be summarised as follows.

The Dutch national reform programme identifies as main priorities: improving labour supply; achieving faster growth in labour productivity, in particular by strengthening R&D, innovation and education; and improving price competitiveness, in particular by containing labour costs.

The Commission's assessment was that the Netherlands made significant progress in implementing its national reform programme over the 2005-2007 period.

Against the background of strengths and weaknesses identified and the evidence on progress made, the Commission recommended that the Netherlands is recommended to give highest priority to the challenges in the area of improving labour supply of women, older workers and disadvantaged groups and, in addition, to focus on the area of R&D.

[4] Communication from the Commission to the European Council, "Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010)", 11.12.2007, COM(2007)803.

Box: Main points covered by the assessment

As required by Article 5(1) (for stability programmes) and Article 9(1) (for convergence programmes) of Council Regulation (EC) No 1466/97, the assessment covers the following points:

- whether the economic assumptions on which the programme is based are plausible;
- the medium-term budgetary objective (MTO) presented by the Member State and whether the adjustment path towards it is appropriate;
- whether measures being taken and/or proposed to respect that adjustment path are sufficient to achieve the MTO over the cycle;
- when assessing the adjustment path towards the MTO, whether a higher adjustment effort is made in economic good times, whereas the effort may be more limited in economic bad times, and, for euro-area and ERM II Member States, whether the Member State pursues an annual improvement of the cyclically-adjusted balance, net of one-off and other temporary measures, of 0.5% of GDP as a benchmark to meet its MTO;
- when defining the adjustment path to the MTO (for Member States that have not yet reached it) or allowing a temporary deviation from the MTO (for Member States that have), the implementation of major structural reforms which have direct long-term cost-saving effects (including by raising potential growth) and therefore a verifiable impact on the long-term sustainability of public finances (subject to the condition that an appropriate safety margin with respect to the 3% of GDP reference value is preserved and that the budgetary position is expected to return to the MTO within the programme period), with special attention for pension reforms introducing a multi-pillar system that includes a mandatory, fully-funded pillar;
- whether the economic policies of the Member State are consistent with the broad economic policy guidelines.

The plausibility of the programme's macroeconomic assumptions is assessed by reference to the Commission services' autumn 2007 forecast, using also the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

The assessment also examines:

- the evolution of the debt ratio and the outlook for the long-term sustainability of the public finances, which should be given "sufficient attention in the surveillance of budgetary positions" according to the Council report of 20 March 2005 on "Improving the implementation of the Stability and Growth Pact". A Commission Communication of 12 October 2006 sets out the approach to the assessment of long-term sustainability[5];
- the degree of consistency with the national reform programme, submitted by Member States in the context of the Lisbon strategy for growth and jobs, and its October 2007 implementation report. In its cover note of 7 June 2005 to the European Council on the broad economic policy guidelines for the period 2005-2008, the ECOFIN Council stated that the national reform programmes should be consistent with the stability and convergence programmes;
- compliance with the code of conduct[6], which inter alia prescribes a common structure and set of data tables for the stability and convergence programmes.

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[5] Communication from the Commission to the Council and the European Parliament, "The long-term sustainability of public finances in the EU", 12.10.2006, COM (2006) 574 final and European Commission, Directorate-General for Economic and Financial Affairs (2006), "The long-term sustainability of public finances in the European Union", European Economy No 4/2006.

[6] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005.

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

On the updated stability programme of the Netherlands, 2007-2010

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

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

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On [12 February 2008] the Council examined the updated stability programme of the Netherlands, which covers the period 2007 to 2010.

(2) Since 2006, Dutch GDP growth again significantly outpaces potential growth. The current upturn is generally assessed to be a regular cyclical upturn and is not widely mistaken for higher potential growth, as was the case during the rather long boom period at the end of the 1990s. Furthermore, it is more broadly based on both domestic and external sources of growth. However, given the good starting position, the tightness of the labour market may exert upward pressures on wages and prices rather early, which would result in an overheating economy.

(3) The macroeconomic scenario underlying the programme envisages that real GDP growth will slow down from 2¾% in 2007 to 2½% in 2008 and 1¾% over the rest of the programme period. Assessed against currently available information[8], this scenario appears to be based on plausible growth assumptions until 2008 and cautious growth assumptions thereafter. Given that there are already signs of overheating in the Dutch

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7 OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm.

8 The assessment takes notably into account the Commission services' autumn forecast and the Commission assessment of the October 2007 implementation report of the national reform programme.

labour market, which is expected to put upward pressure on wages, the programme's projections for inflation of 2% from 2009 appear to be on the low side.

(4) For 2007, the general government deficit is estimated at 0.4% of GDP in the Commission services' autumn 2007 forecast and in the programme (although the latter also mentions the latest official estimate of 0.2% of GDP). The previous update of the stability programme had targeted a surplus of 0.2% of GDP. The main factors contributing to this deterioration are expenditure overruns (especially in health care) and lower gas revenues, while tax revenues have turned out better than targeted. Although budgetary policy continued to respect its medium-term objective (MTO) in 2007, it was not in line with the invitation in the Council opinion of 27 February 2007 on the previous update of the stability programme[9], which invited the Netherlands to maintain a strong structural position in 2007 (and beyond), thereby avoiding pro-cyclical fiscal policies in good times. It was also not in line with the April 2007 Eurogroup orientations for budgetary policies as concerns 2007, since expenditure overruns were thus not avoided and unexpected extra revenues were only partially used to reduce government deficit and debt.

(5) The main goal of the programme's budgetary strategy is to attain a structural surplus, that is, a cyclically-adjusted surplus net of one-off and other temporary measures, of 1% of GDP at the end of the planned government term, in 2011. Hence, throughout the programme period, the Netherlands plans to fully respect its medium-term objective (MTO) for the budgetary position, which is a structural deficit ranging from 0.5 to 1% of GDP. After the significant deterioration in 2007, the programme projects a return to small, broadly stable headline surpluses. The primary balance follows a similar path, stabilising at 2¾% of GDP in 2008-2010. The previous update of the stability programme assumed a growth slowdown in 2008 rather than in 2009 and targeted a broadly balanced general government budget until 2008 and a surplus of almost 1% of GDP in 2009. In the current update, the headline adjustment over the programme period is fully revenue-based and front-loaded in 2008. It is mainly driven by increases in gas revenues, a discretionary increase in social contributions and favourable economic growth perspectives. Government expenditures are planned to be governed by expenditure ceilings in real terms, which have been defined for the whole government term in the draft budget for 2008.

(6) The risks to the budgetary projections in the programme appear broadly balanced until 2008 whilst outcomes could be better than projected from 2009 onwards, as economic growth may be stronger than foreseen in the programme. This is partly compensated by the lack of detail regarding the planned measures. If economic growth turns out better than foreseen in the programme, this should be reflected in a better budgetary outcome from 2009 onwards in order to prevent a pro-cyclical stance of fiscal policy.

(7) In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the MTO by a sizeable margin throughout the programme period, as envisaged in the programme. The fiscal policy stance implied by the programme is in line with the Stability and Growth Pact throughout the period and also with the April 2007 Eurogroup orientations for budgetary policies.

9 OJ C 70, 27.3.2007, p. 21.

(8) The Netherlands appears to be at medium risk with regard to the sustainability of public finances. The long-term budgetary impact of ageing is higher than the EU average, influenced notably by a relatively high increase in pension expenditure as a share of GDP over the coming decades. Yet, the projected future rise of tax revenues as a share of GDP, due to the deferred taxation of private pension, would partly compensate the increase in public expenditure over the long term. The budgetary position in 2007 as estimated in the programme, which is worse than the starting position of the previous programme contributes to offsetting the projected long-term budgetary impact of an ageing population but is not sufficient to cover the substantial increase in age-related expenditure, notably in view of the deterioration of the structural primary balance in 2007 compared to 2006. Ensuring higher primary surpluses over the medium term and/or implementing reform measures that curb the projected increase in age-related expenditure would contribute to reducing risks to the sustainability of public finances.

(9) The stability programme seems to be well consistent with the October 2007 implementation report of the national reform programme. In particular, although the programme does not provide a qualitative assessment of the overall impact of the national reform programme, both documents discuss relevant subsets of the measures embodied in the governments' “six-pillar strategy” that overarches general government policies in the current governments' term. Focusing on measures with a direct budgetary impact, both documents mention the phasing out of the transferability of the general tax credit over a period of 15 years starting in 2009. The stability programme in addition refers to plans to reduce unemployment contributions by employees and employers in 2009, which will be financed by an increase in the VAT rate in the same year.

(10) The budgetary strategy in the programme is broadly consistent with the broad economic policy guidelines included in the integrated guidelines for euro area Member States in the area of budgetary policies issued in the context of the Lisbon strategy.

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

The overall conclusion is that the programme aims at achieving and maintaining a broadly stable surplus, thereby ensuring a sound budgetary position throughout the period. While fiscal policy was pro-cyclical in good economic times in 2007, the budgetary stance in the programme from 2008 onwards is in line with the Pact. The risks to the budgetary targets seem broadly balanced in 2008. From 2009 onwards, if economic growth turns out better than the cautious economic scenario envisaged in the programme, this should be reflected in a better budgetary outcome than planned, thereby avoiding a pro-cyclical fiscal stance. As regards the long-term sustainability of public finances, the Netherlands appears to be at medium risk.

In view of the above assessment and in the light of the projected increase in age-related expenditure and the recent deterioration of the structural balance, the Netherlands is invited to improve the long-term sustainability of public finances by securing the budgetary consolidation as planned in the programme.

Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010
Real GDP (% change)	**SP Nov 2007**	**3.0**	**2¾**	**2½**	**1¾**	**1¾**
	COM Nov 2007	3.0	2.7	2.6	2.5	n.a.
	SP Nov 2006	*3¼*	*3*	*1¾*	*1¾*	*n.a.*
HICP inflation (%)	**SP Nov 2007**	**1.7**	**1½**	**2¼**	**2**	**2**
	COM Nov 2007	1.7	1.6	2.3	2.7	n.a.
	SP Nov 2006	*1½*	*1¾*	*1¾*	*1¾*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Nov 2007**	**-0.6**	**0.0**	**0.4**	**0.1**	**-0.4**
	COM Nov 2007[2]	-1.0	-0.4	0.0	0.3	n.a.
	SP Nov 2006	*-0.5*	*0.6*	*0.6*	*0.3*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Nov 2007**	**7.7**	**6.6**	**6.5**	**7.2**	**7.5**
	COM Nov 2007	7.3	6.6	7.2	7.9	n.a.
	SP Nov 2006	*6.9*	*6.7*	*7.1*	*7.5*	*n.a.*
General government balance (% of GDP)	**SP Nov 2007**	**0.6**	**-0.4**	**0.5**	**0.6**	**0.7**
	COM Nov 2007	0.6	-0.4	0.5	1.3	n.a.
	SP Nov 2006	*0.1*	*0.2*	*0.3*	*0.9*	*n.a.*
Primary balance (% of GDP)	**SP Nov 2007**	**2.8**	**1.8**	**2.7**	**2.7**	**2.7**
	COM Nov 2007	2.8	1.8	2.7	3.3	n.a.
	SP Nov 2006	*2.4*	*2.4*	*2.4*	*2.9*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**SP Nov 2007**	**1.0**	**-0.4**	**0.3**	**0.5**	**0.9**
	COM Nov 2007	1.1	-0.2	0.5	1.1	n.a.
	SP Nov 2006	*0.4*	*-0.1*	*0.0*	*0.7*	*n.a.*
Structural balance[3] (% of GDP)	**SP Nov 2007**	**1.0**	**-0.4**	**0.3**	**0.2**	**0.9**
	COM Nov 2007	1.1	-0.2	0.5	0.7	n.a.
	SP Nov 2006	*0.4*	*-0.1*	*0.0*	*0.4*	*n.a.*
Government gross debt (% of GDP)	**SP Nov 2007**	**47.9**	**46.8**	**45**	**43**	**41.2**
	COM Nov 2007	47.9	46.8	44.8	41.7	n.a.
	SP Nov 2006	*50.2*	*47.9*	*46.3*	*44.2*	*n.a.*

Notes:

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

[2]Based on estimated potential growth of 2.1%, 2.2%, 2.2% and 2.2% respectively in the period 2006-2009.

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

Source:

Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations