



Ministerie van Financiën

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Subject Effective action in the Excessive Deficit
Procedure of the Netherlands

Ons kenmerk
BFB 2010 641M

Dear Commissioner Rehn,

dear Olli,

On 2 December 2009, the Council adopted recommendations to the Netherlands in the context of the Excessive Deficit Procedure as a result of an expected budget deficit for 2009 above the 3%-threshold as specified in the TFEU. Specifically, the Council adopted the following recommendation concerning effective action: *The Council establishes the deadline of 2 June 2010 for the Dutch government to take effective action to implement the fiscal measures in 2010 as envisaged and to outline the consolidation strategy in some detail that will be necessary to progress towards the correction of the excessive deficit.*

On 29 January 2010 an update of the Dutch Stability Programme was submitted. The opening chapter of the update outlined the government's strategy to implement the Council recommendations. With this letter I inform you on the most recent budgetary developments and the decisions taken by the government in response to these recommendations, in the context of the current caretaker status of the Dutch government and the upcoming national elections on June 9. This letter also provides the latest medium-term projections by the CPB Netherlands Bureau for Economic Policy Analysis and an update on the government's consolidation strategy presented in the 2010 update of the Stability Programme.

Measures in 2010

In line with the Council recommendations, the government has implemented the measures envisaged in the 2010 Budget Memorandum. More specifically, the government has not announced additional stimulus measures but has instead further implemented the designed policy packages to stimulate the economy in 2009 and 2010, in line with the European Economic Recovery Plan, whilst at the same time adhering to the revenue and expenditure ceilings.

Despite these measures, the budgetary outlook has worsened to a general government deficit of 6.6% of GDP. As table 1 displays, all structural shortfalls have been corrected by the government, and in doing so, the expenditure ceilings have been adhered to. In order to do so the government adopted measures to counteract the threat of expenditure overruns. The expenditure overruns primarily materialized in health care, but also in the fields of asylum policy, education and child care, and agriculture. The government measures taken to offset these overruns included cutting back the expenditures of different ministries, but also included different measures in health care.



Moreover, the corrective measures taken, imply that no reimbursements are granted for inflation or increased wages.

The worsening of the general government budget relates to a technical one-off concerning the capital injection in ABN AMRO (-0.2% of GDP) and set-backs only of an endogenous nature (-0.1% of GDP). CBS Statistics Netherlands has judged that part of an earlier capital injection in ABN AMRO should be classified as a capital transfer, hence being relevant for the EMU-balance, and therefore worsening the general government balance compared to the 2010 Budget Memorandum. Lastly, there have been set-backs of an endogenous nature. Spillovers from the 2009 recession account for the majority of the lower than expected revenues for 2010. The revenue forecast is adjusted because of significantly lower expected corporate income tax receipts, VAT-receipts and gas revenues. On the positive side, interest expenditures, a moderate denominator effect and a moderate wage-price differential positively affected the deficit.

Table 1: development EMU-balance 2010 (in % GDP)

	2010
General government balance - Budget Memorandum 2010	-6.3%
Fixed real expenditure ceilings	0.0%
<i>Of which central government</i>	0.2%
<i>Of which health care</i>	-0.2%
Macroeconomic effects:	-0,1%
<i>Of which government revenues</i>	-0.3%
<i>Of which natural gas</i>	-0.1%
<i>Of which interest</i>	0.1%
<i>Of which denominator effect</i>	0.1%
<i>Of which wage price differential</i>	0.1%
One-offs:	
Capital injections Fortis Bank NL / ABN AMRO	-0.2%
General government balance - Spring memorandum 2010	-6.6%

Government debt is currently expected to be in line with the projections of the 2010 Budget Memorandum. Finally, contingent liabilities have increased as a consequence of the 60 billion European Financial Stability Mechanism (of which the Dutch part amounts to a maximum of 3 billion euro) and the 440 billion European Financial Stability Facility (of which the Dutch part amounts to a maximum of 26 billion euro).

Strategy 2011-2013

Since the reasons for the downward revision of the budget deficit in 2010 are of a one-off or cyclical nature, the government has not revised the deficit forecasts as notified in the January 2010 update of the Stability Programme for 2011 and later years. For the budgetary outlook, the government bases itself on the medium-term forecasts of the independent CPB Netherlands Bureau for Economic Policy Analysis, which forecasts the EMU deficit to improve by 18 billion euros in real terms between 2010 and 2013.

Revenues will improve significantly because corporate tax receipts are rebounding after a couple of years of very low levels and because income tax receipts show a strong progression as a result of the expected real wage increase. Revenues will also improve due to the reversal of the fiscal stimulus package. These factors together will increase the tax burden by 1.3%-point between 2010



and 2013. As a result, the budget deficit is expected to improve from 6.6% of GDP in 2011 to 3.0% of GDP in 2013, excluding additional measures for further fiscal consolidation that will be taken by the next government. The budgetary path presented in table 2 below must therefore be considered as a minimum benchmark. The deficits of both the general and local governments are expected to fall between 2010 and 2013. The EMU-balance will improve most significantly in 2011. This is almost entirely due to the reversal of crisis spending measures and to the budget cuts already decided by the government and adopted by the parliament, which amount to €1.8 billion. Furthermore, the current caretaker government has the intention to adhere to the revenue and expenditure ceilings in the upcoming 2011 Budget Memorandum.

Table 2: EMU balance, structural EMU balance and gross government debt over 2010-2013

	2010	2011	2012	2013
EMU balance	-6,6	-4,9	-3,8	-3,0
Structural EMU balance (EC-method)	-4,9	-4,0	-3,4	-2,8
Gross government debt	66	68,9	70,7	71,9

Source: 2010: Spring Memorandum 2010, 2011-2013 CPB Medium-Term Projections 2011-2015

Building on this baseline scenario, the government intends to stick to its policy line that, after fiscal stimulus in 2009 and 2010, fundamental consolidation plans are to be implemented in 2011 and beyond. The sophisticated and well-tested budgetary rules of the Netherlands will be instrumental in delivering on the ambitious budgetary targets. Moreover, the government has made further progress in the strategy for ensuring durable consolidation. To inform political parties and the public at large ahead of the elections of June 9 and to facilitate the formation of a new coalition, the government has decided to speed up both the Fundamental Budget Review and the Budgeting Framework Commission (see box below). Their reports have been delivered on April 1, one month ahead of schedule, and have helped to build the wide-spread consensus on the need for vigorous budgetary consolidation. In their election platforms, all main political parties lay out credible, attainable and far-reaching consolidation measures in both the medium- and long-term. In fact, for the years 2011-2015, all main political parties propose additional consolidation ranging from 10 to 20 billion euro (2-3% GDP). This should guarantee adherence to the EDP-recommendation, whilst also contributing to moving towards the Dutch Mid-Term Objective (MTO) hereafter.

To ensure the sustainability of public finances, in addition to the planned consolidation measures in the next cabinet period, most main parties propose important structural reforms, such as raising the statutory retirement age. These actions aim to close the sustainability gap of 4.5% of GDP as calculated by the CPB Netherlands Bureau for Economic Policy Analysis in its most recent medium-term projections. Most of these parties even go beyond 4.5% of GDP, as the average sustainability package amounts to 5.3% of GDP. In this regard, it is important to note that the plans as set out by political parties have been confirmed by the CPB in its traditional analysis of political parties' election programmes "Keuzes in Kaart 2011-2015" as presented on May 20. On the basis of this analysis, one can thus safely conclude that the current political debate does not revolve around the question whether consolidation is necessary, but only concerns the speed with which measures will have to be taken. Even the party that plans to consolidate least in the next cabinet period will ensure that the Council recommendations in the context of the Excessive Deficit Procedure will be met.

The Fundamental Budget Review (FBR)

In response to the budgetary deterioration stemming from the crisis, the government established 20 high-level groups to identify structural reform and saving options for key policy areas. All groups have succeeded in their mission to present at least one reform scenario resulting in a 20% structural expenditure reduction. As a consequence, potential savings totalling 30-40 billion euro have been identified. This large amount (around 5% of GDP) is explained by the fact that the



groups present options, not fixed solutions, and that, rather than with relatively straight forward across-the-board expenditure cuts, the FBR deals with genuine structural reforms that will also improve long-term sustainability. To complement the FBR, an additional group on the tax system considered the revision of taxation in light of the economic efficiency of the system, the stability of tax revenues, the sustainability of tax bases and the room for simplification. According to the committee, the current trend of broadening the base of tax with a simultaneous reduction of rates should be continued.

The Budgeting Framework Commission (BFC)

The Budgetary Framework Commission traditionally advises the incoming government on the budgetary policies and targets. The new government is not required to follow the advice, but based on previous experiences advices drawn up by the Commission have proven very influential. For instance, the current trend-based budget policy was advised on by the BFC. The core message of the current report is that the next government should adopt measures to save 29 billion euros in the long-term in order to secure healthy and sustainable public finances. The budgetary challenge for the medium- to long-term will have to meet requirements of the Stability and Growth Pact. The Stability and Growth Pact should therefore act as an anchor for yearly decision-making. Taking the medium-term projections by the CPB Netherlands Bureau for Economic Policy Analysis as a minimum benchmark, the BFC states that a substantial part of the additional consolidation measures, 18 billion euros, should already take its effect in the next government's term, assuming a prudent scenario. This minimum requirement is complementary to increasing contributions and own payments in the health care sector (or alternatives) that are part of the Economic Outlook 2011 - 2015 of the CPB Netherlands Bureau for Economic Policy Analysis. According to the BFC, a package as such offers perspective on a balanced budget on a structural basis, thereby complying to the Medium-term Objective of the Netherlands. Thereby, the BFC advises to implement a package of at least 1½% GDP of sustainability measures to address the budgetary costs of an ageing population. The Commission also recommends that budgetary policy be sharpened to manage downward risks and to get more security on the realisation of budgetary targets, without sacrificing the tested elements of the trend-based budget policy. In particular, the arguments formulated by the previous BFC to keep expenses on unemployment, social security benefits and real price adjustments of the expenditure ceilings under discipline of the expenditure ceilings, still apply. Therefore, the BFC advises the government cease correcting expenditure ceilings in the next term. In addition, the BFC recommends to again placing interest payments under the expenditure ceilings.

Conclusion

The Netherlands is fully committed to the implementation of the Excessive Deficit Procedure recommendations. The government has implemented the measures envisaged in the 2010 budget and has taken corrective measures regarding new budgetary overruns in 2010. These overruns are of a cyclical or one-off nature and are not expected to weigh on the deficit in 2011 and later years. The government has also taken action to implement its strategy for lasting durable consolidation and progress towards long-term sustainability of public finances. The Fundamental Budget Review and the Budgeting Framework Commission have been asked to finish their work a month earlier than originally foreseen, so that their work can be influential in informing the next government's policies. The Budgeting Framework Commission has advised consolidation measures of 29 billion euro, of which 18 billion during the next government's term, while the reports of the Fundamental Budget Review present a wealth of structural reform options to achieve such a consolidation effort. The election platforms of all major political parties ahead of the June elections illustrate the broad-based consensus regarding the need of budgetary consolidation.

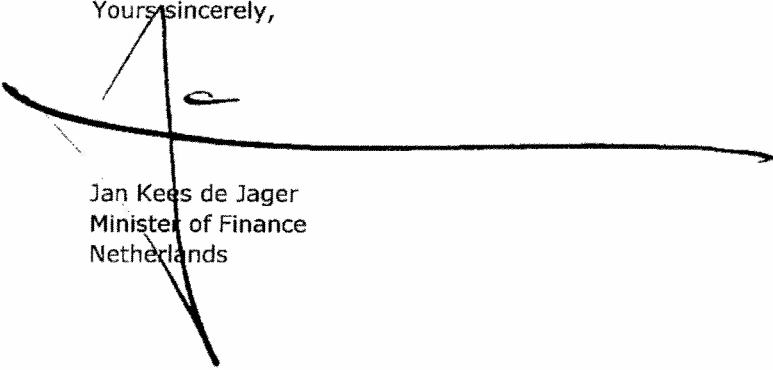
All in all, the Netherlands is well on track to correct the excessive deficit by 2013. The Netherlands has a sophisticated and well-tested set of budgetary rules in place. The 'trend based budgetary policy' has provided the Netherlands with an excellent track record and will be instrumental in



achieving the necessary fiscal consolidation during the coming years. Moreover, in the budgetary process, the government bases its decisions on the analysis and economic forecasts of an independent institution (the CPB), thus ruling out any bias in the growth projections and in the foreseen (budgetary) impact of consolidation efforts. In combination with the substantial input from the Fundamental Budget Review, the Budgeting Framework Commission and the credible commitment of all political parties to significantly consolidate further, I am more than confident that the Netherlands, by remaining fully committed to the provisions of the Stability and Growth Pact, will fully respect and fulfil the Council recommendations in the context of the Excessive Deficit Procedure.

Please do not hesitate to contact me if you require additional information on the Dutch consolidation strategy.

Yours sincerely,



Jan Kees de Jager
Minister of Finance
Netherlands