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Summary

The Dutch economy is expected to grow steadily in 2016 and 2017; unemployment is falling gradually. The actual budget deficit drops to 1.2% of GDP in 2017, but the structural deficit (budget deficit corrected for cyclical and one-off measures) rises in 2015 and 2016. In both 2015, 2016 and 2017 the structural deficit exceeds the European medium-term budgetary objective of 0.5% of GDP.

Since 2014, in the context of independent budget supervision, the Advisory Division has assessed whether actual and forecast development of public finances comply with the rules in the Stability and Growth Pact. In respect of 2015, the Advisory Division concludes that Dutch public finances in 2015 did not fully comply with European fiscal rules. In respect of 2016 and 2017, based on the 2016 CEP projections of the CPB Netherlands Bureau for Economic Policy Analysis (CPB), the Advisory Division concludes that the Dutch budget for the structural balance will not comply with European fiscal rules. That equally applies for 2017 in respect of the European expenditure rule. In terms of European rules, the deviation of the expenditure rule is a so-called 'significant' deviation. The aforegoing could mean that the European Commission would implement an overall assessment, and proposes on such basis to the Council of Ministers, to direct one or more country-specific recommendations to the Netherlands.

The Advisory Division ascertains that the government has fully committed itself in the Stability Programme to the European budgetary agreements and intends to adhere to the regular national budgetary framework. Based on the CEP, that would imply that the government would have to reduce spending in 2017 by € 2.7 billion and increase taxes in that year by € 1.2 billion (these amounts are subject to readjustment based on the latest information). Since the government provides no insight in the Stability Programme about how to accomplish this in a concrete manner, the Advisory Division cannot, for the time being, express any opinion on this yet. The Advisory Division notes that if the government indeed complies fully with the national budgetary rules, the deviations will no longer be significant in terms of the European rules. The information in the Stability Programme over the past period suggests, however, that a considerable policy effort is still needed in the months ahead.

Finally, the Advisory Division ascertains that current forecasts are surrounded by relatively many (international) uncertainties. According to CPB, risks are mainly downwards. In addition, Dutch public finances are relatively sensitive to cyclical shocks. By taking adequate measures now to comply with European fiscal rules, there will be greater (budgetary) scope for considering new societal challenges on the one hand, and the creation of desirable room for budgetary manoeuvre in more

difficult years on the other in the future. The uncertainties underline the importance of having sufficient room for budgetary manoeuvre in the budgetary policy, according to the Advisory Division.

1. Introduction

The Advisory Division of the Council of State has been designated as the body responsible for the independent supervision of compliance with European fiscal rules as provided for in the Treaty on Stability, Coordination and Governance (TSCG) and Article 5 of Regulation 473/2013/EU. It is the task of the independent budget supervision institution to draw up assessments which are available to the public, on whether a country complies with European budgetary agreements.

Given the essential steps in the budgeting process, both nationally and on a European level, the Advisory Division previously concluded that a spring report is desirable. In the spring, CPB Netherlands Bureau for Economic Policy Analysis (CPB) publishes its short-term economic and budgetary forecasts for the coming year. Also, the government determines the outlines of the budget for the coming year. The annual Stability Programme is submitted to the European Commission at the latest by 30 April. The Spring Report by the Advisory Division ties in well with this and therefore forms a logical part of the policy cycle agreed to within the European Union. In this context, within the European Union, the annual macroeconomic policy, the budgetary policy and the policy geared towards structural reforms between Member States, is discussed and matched up with each other. This so-called 'European semester' starts in November with the publication of two reports by the European Commission, the Annual Growth Survey and the Alert Mechanism Report, about the growth strategy which details key priorities in the field of promoting economic growth, job opportunity and public finances, and are discussed and matched up in mutual coherence.[1] In the spring, Member States report via publications of their Stability Programme and National Reform Programme.

Last spring the Advisory Division published a Spring Report for the first time.[2] An English translation of the report will also be presented to the European Commission, so that it is given the opportunity to include the report in its evaluation of the Dutch Stability Programme in May.

The assessments are established in cooperation with CPB. The division of tasks entails that the drawing up of independent forecasts and analyses are assigned to CPB; the Advisory Division is charged with a more normative assessment of compliance with European budgetary agreements. In the spring the Advisory Division thus makes use of current projections published in the Central Economic Plan (CEP).

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1 See, for example, EC, Annual Growth Survey 2016: Strengthening the recovery and fostering convergence, 26 November 2015 (COM(2015) 690 final), and EC, Alert Mechanism Report 2016, 26 November 2015 (COM(2015) 691 final).

2 Spring 2015 Budget Supervision Report, no. W06.15.0090/III, 13 April 2015 (appendix to Parliamentary Papers II 2014/15, 21 501-07, no. 1249).

In the interests of quality and accuracy of the assessment to be drawn up, the Advisory Division is provided with the draft version of the Stability Programme. Then the Advisory Division draws up a draft assessment. The government has been informed of this and the draft assessment is discussed with the government. After taking note of the response from the government and the draft Stability Programme as submitted to the States General, the Advisory Division ascertains its final assessment. The government's response is included in full in this report. In this way the procedure guarantees that justice is done to the respective responsibilities and possible differences of opinion and this is reported in the final assessment.

The assessment framework maintained by the Advisory Division for the independent budget supervision stems from the Stability and Growth Pact (SGP) of 1997, and its subsequent adaptations, especially the so-called ‘Six Pack’. Member States have also accepted additional commitments in the inter-governmental Treaty on Stability, Coordination and Governance in the EMU, which entered into force in 2013 and is further put into operation in two Regulations (the so-called ‘Two Pack’).

Section 2 of this report contains a short discussion on the macroeconomic and budgetary prospects. Section 3 reviews the budgetary prospects and the Stability Programme to the assessment framework. Section 4 reflects the government's response to the draft assessment. Section 5 concludes with the final assessment.

2. Macroeconomic and budgetary prospects

2.1 The macroeconomic prospects in 2016 and 2017

Since 2014 the economy in the Eurozone has grown steadily, albeit at a moderate pace. After less than 1% economic growth in 2014, in its recently published 2016 CEP, CPB forecast growth for 2016 and 2017 of 1.6% respectively 1.7% for the Eurozone. This means that the expected growth for 2016 is somewhat lower than was projected in September. Uncertainties are still significant, as is also apparent from the recent volatility in the financial markets. Uncertainties in Europe become greater due to the developments in the influx of refugees and possible consequences related to this. The referendum in the United Kingdom on a possible 'Brexit' also contributes to the prevalent uncertainty. Specific risks from abroad are therefore mainly downwards.

Since 2014 the Dutch economy has grown stronger than the economy of the Eurozone (see table 1). For 2016, CPB currently projects a growth of 1.8% for the Netherlands, and a growth of 2.0% for 2017. Growth in the market sector excluding gas extraction is even stronger; here CPB projects a growth of 2.3% in 2016 and 2.6% in 2017.

Figure 1 shows that only since the beginning of 2015 the level of economic activity in the Netherlands has returned to the level achieved prior to the financial crisis. This vividly illustrates the deep and long-term recession that took place and the subsequent moderate and hesitant recovery.

Figure 1: Economic growth (GDP) in the Netherlands, 2008-2017

Since 2015 consumption expenditure for households has risen again, but the 2008 level will only be achieved in 2017. The inhibiting effect of falling housing prices is no longer present and the increasing number of transactions in the housing market and wealth effects facilitate the purchasing of durable consumer goods. For the first time in ten years, prospective growth percentages of more than four percent are estimated again for the acquisition of durable consumer goods. Because many of these durable goods are imported from abroad, the hefty current account surplus that arose since 2008 is expected to drop somewhat in 2017, but will remain at a relatively high level.[3] The rising housing prices help in the recovery of the financial balances of households: the number of homes with 'underwater mortgages' is clearly reducing.[4] Nonetheless, the balance recovery mechanism for households is a long-term process.

Investments in housing are recovering well in 2015 and 2016. The level of investments in housing in the period before that, however, fell by 40%, so that the level prior to the crisis is still far from being achieved. Exports of goods and services has benefited from the depreciation of the euro in 2015, a consequence of exceptional monetary easing at present by the European Central Bank.

Table 1: Key statistics of macroeconomic developments

((average) changes in % per annum)	**2010-2014**	**2015**	**2016**	**2017**
Eurozone				
Gross domestic product (economic growth)	0.7	1.6	1.6	1.7
The Netherlands				
Gross domestic product (economic growth)	0.5	2.0	1.8	2.0
Household consumption	-0.5	1.5	1.6	2.0
Investments in housing	-7.6	26.8	7.7	4.1
Private investments in other fixed assets	1.5	8.4	5.7	3.7
Exports of goods and services	5.0	5.3	3.6	4.1
Employment market sector	-0.3	1.4	1.4	1.2
Unemployment (year-end level, % of workforce)	7.4	6.9	6.5	6.3

Source: Statistics Netherlands, Statline Database; and CPB, 2016 Central Economic Plan

Employment in the market sector rises by more than 1% per annum from 2015 to 2017. After a number of declining years and stabilisation, job opportunities in the healthcare sector show a slight increase for the first time again in 2017.[5] In 2016 and 2017 the supply of labour, however, will rise substantially as a result of policy measures (raised statutory retirement age; the recent tax-relief measures mainly intended for workers) and because people are returning to the labour market after they had withdrawn themselves during the years of recession. The aforegoing means that unemployment is expected to decline gradually, from 7.4% of the workforce in 2014 to 6.3% in 2017. However, as not only reported in the CEP, but also in a recent publication by the Dutch Central Bank (DNB) it is pointed

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[3] For a more detailed analysis of the current account surplus see also EC, Country Report The Netherlands 2016, Including an in-depth review on the prevention and correction of macroeconomic imbalances, 26 February 2016 (SWD (2016) 87 final).

[4] See for example De Nederlandsche Bank (Dutch Central Bank, DNB), 2015 Annual Report, page 40.

[5] This means that employment in the healthcare sector in 2017, will be almost 60,000 full-time equivalents lower than in 2012. When compared to ten years ago, however, employment in the healthcare sector in 2017 – despite the expenditure cuts of recent years – is almost 10% higher (119,000 full-time equivalents). See CPB's 2016 Central Economic Plan, 21 March 2016, appendix 7.

out that in the definitions of unemployment and workforce, a rather large group has not been taken into consideration.[6] This particularly concerns people who would like to work longer hours and those who are available to work in the labour market in the somewhat longer term. This could possibly explain why the downward pressure on salaries and wages is greater than the unemployment rate in itself suggests, and therefore the persistent wage restraint and relatively promising profitability in businesses.

2.2 Public finances in 2016 and 2017

Table 2 contains several key statistics on public finances. The table shows that the public expenditure ratio reflects a decreasing trend since 2013. Due to the recovering economy, expenditure for unemployment benefits is decreasing. Alternatively, various expenditure cut-back measures have an increasing budgetary yield, which likewise contributes to a reduction of the public expenditure ratio. Higher costs associated with the sheltering of asylum seekers restrict the decline slightly.

Juxtaposed to the relative reduction of public expenditure is an increase in tax and national insurance contributions. This increase is partially explained by endogenous causes, such as growth of the tax base. In 2016 this endogenous development of tax and national insurance contributions is neutralized by tax-relief measures of the so-called '€ 5 billion package'. The decline in non-tax revenues is largely explained by reduced natural gas revenues, a consequence of both a reduced natural gas price as well as a lower production volume due to increased earthquake risks in Groningen.

Table 2: Key statistics on public finances

(in % of GDP)	**2012**	**2013**	**2014**	**2015[a]**	**2016**	**2017**
Gross public expenditure	47.1	47.1	46.4	44.9	43.8	43.4
Tax and national insurance contributions	36.0	36.6	37.5	37.5	37.5	37.7
Non-tax revenues	7.2	8.1	6.6	5.5	4.6	4.5
Actual general government balance	-3.9	-2.4	-2.4	-1.9	-1.7	-1.2
of which *General government balance for local governments*	*-0.4*	*-0.4*	*-0.3*	*-0.3*	*-0.3*	*-0.2*
Structural general government balance	-2.3	-0.8	-0.6	-1.0	-1.6	-1.2
Public debt	66.4	67.9	68.2	66.3	65.4	64.1

Source: CPB, 2016 Central Economic Plan

(a) Statistics Netherlands published actual figures for 2015 on 25 March 2016. These were still unknown at the time of the CEP publication. For the sake of consistency, the figures from the CEP are shown in this table for 2015. The differences between CBS and CPB are fractional.

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6 DNB, *Arbeidsmarkt ruimer dan werkloosheid doet vermoeden* [Labour market less tight than unemployment implies], DNBulletin, 25 February 2016.

On balance, higher revenue and reduced expenditure lead to a lower budget deficit. After a minor improvement of the actual general government balance in 2016 the actual budget deficit is expected to improve by 0.5pp of GDP in 2017, resulting in an actual general government balance, according to current projections, of −1.2% of GDP in 2017. That is an improvement of 2.7pp of GDP in comparison to 2012. General government balance forecasts of local and regional governments show a steady improvement, so arrangements in the Financial Agreement between the central government and local governments dating back to January 2013 are complied with regarding a gradual deficit decline of local and regional authorities.[7]

By adjusting the actual balance for the projected effect of the upturn and for one-off items and temporary measures, a structural balance is obtained which is relevant for European fiscal rules. In 2016, aside from the correction for the status of the economy, there is such a one-off item: the Dutch rebate in payments to the European Union since 2014 is being received retrospectively. The actual budget balance for the year 2016 is distorted as a result of this by 0.3pp of GDP in a favourable sense.[8]

Moreover, according to CEP projections, the structural balance in these relatively favourable years in the economy, will increase again compared to 2015.[9] For 2016 a structural deficit is foreseen which is 1pp of GDP higher than was achieved in 2014. In section 3, at the discussion of the budgetary prospects for 2017, it will be evident that this will significantly burden policy efforts in the coming financial year.

2.3 The medium-term outlook

CPB recently published a forecast for the medium-term (2018-2021), assuming unchanged policy.[10] In this period CPB envisages steady growth of the economy, both for the Eurozone as well as for the Netherlands. A growth of 1.6% per annum is assumed for the Eurozone. Annual growth of the Dutch economy is forecast at 1.8%, consisting of 1.6pp of long-term trend growth and 0.2pp recovery growth. In the projection of future growth, CPB assumes that production capacity will only be used to its full potential in 2023. Estimated potential growth for the period 2018 to 2021, which is broadly based, is higher than calculated in the directly preceding medium-term forecasts, although it is lower than in the years prior to the financial crisis.

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[7] See Parliamentary Papers II 2012/13, 33 400-B, no. 7.

[8] The European Commission, for that matter, applies a uniform assessment framework for all Member States in respect of such corrections. See EC, Report on Public Finances in EMU 2015, European Economy Institutional Papers, no. 014, December 2015, page 52 et seq.

[9] In the years 2015 and 2016 actual economic growth exceeds the potential growth trend: the so-called output gap (difference between the actual production level and estimated production capacity) will reduce in these years.

[10] CPB, *Middellangetermijnverkenning 2018-2021* [Medium-term Outlook 2018-2021], 30 March 2016.

The international outlook shows major uncertainties, and CPB stresses that those uncertainties are "mostly downwards".[11] In this sense, CPB also mentions developments in the European Union (the possibility of a new debt crisis, a possible Brexit, and a suspension of the Schengen Agreement for a longer time), a persistent terrorist threat, uncertainty about the monetary policy in Europe and USA, a possible 'hard landing' of the Chinese economy as well as developments in the financial markets. If these risks would truly manifest themselves, the outlined growth path would become significantly disrupted according to CPB.

On the basis of projections in the past and the realisations of those projections, it can be calculated that average forecast errors, seen over a longer period admittedly are limited, but also that potential fluctuations around that average could be substantial. The presented estimate of 1.8% economic growth per annum contains a wide margin of uncertainty: there is a 67% chance that growth will be between 1.0% and 2.6% per annum.[12]

The steady recovery of the Dutch economy also translates, under various assumptions, into an improvement of public finances. Assuming no policy changes, the multi-year figures for public expenditure (narrow definition, i.e. without social security, healthcare, interest expenses) and social security, imply steady real expenditure in both areas for the 2018-2021 period. This partially results from further increasing budgetary revenues of a number of policy measures decided on in the current government's term (including the increase of the statutory retirement age and the introduction of the Participation Act). However, assuming no policy changes, healthcare expenditure is forecast to grow by 3.4% per annum. That is significantly higher than the 1.1% per annum for the period 2011-2017. For those years, policy measures have substantially restricted growth in healthcare (by 2.4% per annum).

The aforegoing means that forecast actual growth of total public expenditure for the period 2018-2021 is fully concentrated on healthcare and the costs of linked earnings in the public sector. For social premiums covering expenses for the Health Insurance Act (Zvw) this also means an increase in national insurance contributions of more than € 6 billion. This restricts disposable income for households and contributes to the fact that purchasing power across the board hardly improves.

Table 3 places public expenditure in a long-term perspective which takes a retrospective look at developments over the last decade. The table shows that so-called 'automatic stabilizers' have done their job during the crisis to (partially)

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[11] CPB, *Middellangetermijnverkenning 2018-2021* [Medium-term Outlook 2018-2021], 30 March 2016, page 6.

[12] The standard deviation of the forecasting error for economic growth (GDP) is calculated at 0.8pp per annum over the period 1981-2017, excluding the recession of 2008-2011. See CPB, *Middellangetermijnverkenning 2018-2021* [Medium-term Outlook 2018-2021], 30 March 2016, page 10.

curtail the recession: from a limited surplus of 0.2% of GDP in 2006, the budget balance turned into a deficit of 5% of GDP in 2010. Since 2011 the response to this was to gradually introduce a substantial package of expenditure cut-back measures and increases in the tax burden, rising to € 46 billion per annum in 2017.[13] These measures, as well as economic recovery, lead to the considerable budget deficit of 2010 being expected to be reduced to 1.2% of GDP in 2017. In CPB's medium-term forecast the actual budget balance in 2021 – under the assumption of unchanged policy – will result in a surplus of 0.6% of GDP.

Table 3: Key statistics on public finances

(in % of GDP)		**2006**	**2010**	**2012**	**2017**	**2021**
Public expenditure (narrow definition)[(a)]		22.6	24.9	23.2	20.9	20.0
of which	*public administration*	*9.5*	*10.3*	*9.8*	*8.7*	*8.2*
	education	*5.1*	*5.5*	*5.3*	*5.2*	*4.9*
	security[(b)]	*2.9*	*3.1*	*3.0*	*2.6*	*2.6*
	infrastructure	*1.7*	*1.9*	*1.6*	*1.4*	*1.3*
Interest expenditure		2.0	1.8	1.6	1.2	0.9
Social security		11.0	12.1	12.4	11.7	11.1
of which	*Old-age pension / Surviving dependants' pension*	*4.4*	*4.7*	*5.0*	*5.1*	*4.8*
	Unemployment Act and Social Assistance Benefit	*1.8*	*2.0*	*2.2*	*1.8*	*1.6*
Healthcare		8.0	9.4	9.8	9.4	9.9
Total gross public expenditure		43.5	48.1	47.1	43.4	41.9
Tax and national insurance contributions		36.4	36.1	36.0	37.7	38.6
Other income[(c)]		7.3	7.1	7.2	4.5	4.0
of which	*Gas revenues*	*1.5*	*1.5*	*2.0*	*0.3*	*0.3*
General government balance		0.2	-5.0	-3.9	-1.2	0.6

Source: CPB, 2016 Central Economic Plan, appendix 8; CPB, Medium-term Outlook 2018-2021

(a) Concerns public expenditure excluding expenses for interest, social security and healthcare.

(b) Concerns expenditure for homeland security and defence.

(c) Concerns non-tax revenues.

Total public expenditure as a share of GDP in 2017, is projected at relatively the same level as in 2006, in other words (gross) public expenditure, on balance, has grown since then at the same pace as the economy. In the first five years after 2006 growth in public expenditure has been far stronger than growth of the economy, but from 2012 growth in public expenditure – so too in healthcare and social security – has been lagging far behind economic growth. This is attributable to the economic recovery and the considerable austerity measures that have taken

[13] 2016 Stability Programme, table 3.1.

place. In the medium-term forecast up to 2021 public expenditure will decline, mainly due to growth of public expenditure (narrow definition) lagging behind economic growth, reduced interest expenditure and lower expenses for social security.

Table 3 also provides an overview of long-term development of the composition of public expenditure. From this it is apparent that the composition of public expenditure has changed a great deal in the last decade and that this trend, on the assumption of unchanged policy in the medium-term forecast, will continue after 2017.

Despite various policy measures in these areas, the share of healthcare and state pension expenses in the total public expenditure, has clearly increased between 2006 and now. Upward pressure of the ageing population, technological developments and linking earnings to wage development in the market sector, on balance, has been stronger than the dampening effect of measures taken. In the medium-term outlook to 2021 State pension expenditure shows a relative decline, due to the increase in State pension expenses lagging behind as a result of a gradual increase of the statutory retirement age to 67 in 2021. After a temporary decrease as a result of (considerable) policy measures in the current government term, healthcare expenditure increases again after 2017, however, partly because of demographic developments.

Expenditure for social security (except for State pensions) and education has increased almost equally with economic growth over the entire period. Interest expenditure dropped substantially. Expenditure for public administration, security (particularly defence) and infrastructure have declined relatively strongly due to various interventions (including freezing salaries and wages and volume-based measures) and, according to projections, will also remain so for the medium-term after 2017. With due observance of various assumptions related to the medium-term outlook (including for example, a decreasing number of young people and a reduced population growth), the trend seems to continue that expenditure important for future growth (education, research, infrastructure) increasingly appears to be ousted by government consumption expenditure.

Decline of the government's other income, particularly from 2014, for a large part is explained by a huge drop in natural gas revenues. Increased risks of earthquakes in Groningen in recent years has forced a severe constraint on gas extraction. In addition, there was a sharp drop in prices. Where gas revenues still amounted to 2.0% of GDP in 2012, for 2017 the current forecast is only 0.3% of GDP.[14] Moreover, particularly lower dividends from state-owned enterprises and reduced interest revenues explain the reduced other revenue.

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[14] In the Minister of Finance's traditional Initial Policy Memorandum at the beginning of the government term, natural gas revenues for 2017 were still forecast at 1.4% of GDP (Parliamentary Papers II 2012/13, 33 400, no. 18).

The burden of tax and national insurance contributions in 2017 is 1.3pp of GDP higher than in 2006. This shows that approximately one-third of the package of budget deficit constraint measures consisted of increased tax burdens. The package of tax-relief measures has minimised this portion slightly as from 2016 (the so-called '€ 5 billion package'). In the medium-term forecast period, tax and national insurance contributions increase further to 38.6% of GDP in 2021. This increase is mainly a result of assuming, in accordance with the current system, premiums covering expenses for Health Insurance (Zvw). Higher healthcare expenditure, insofar as it concerns expenses financed for the Zvw, is thus reflected as higher tax and national insurance contributions and leads to a restriction of disposable incomes and the purchasing power of households.

3. Assessment of the budgetary forecasts and the Stability Programme

3.1 Assessment framework

In the context of independent budget supervision, the Advisory Division assesses whether actual and forecast development of public finances comply with the rules with which the Netherlands must be compliant due to budgetary agreements made in the Stability and Growth Pact (SGP).

After the excessive deficit in 2013 had been corrected, the Netherlands finds itself in the so-called preventive arm of the SGP since 2014. Based on this, the assessment mainly focuses on the question whether the *structural budget balance* complies with the applicable medium-term budgetary objective (MTO) for the Netherlands, or whether sufficient improvement is visible in the direction of the MTO. At this point in time an MTO of –0.5% of GDP applies for the Netherlands. In other words, the Dutch structural budget deficit, according to European fiscal rules, may not be more than 0.5% of GDP, or in any case, moving at a satisfactory pace in that direction. This objective – as follows from European budgetary agreements – is updated every three years and derived from, among other things, the long-term sustainability of public finances of a member country.[15]

In addition to the structural balance it should be assessed whether *growth of public expenditure* does not extend beyond, respectively, lags behind forecast potential growth of the economy, unless compensated by discretionary measures on the revenue side.[16] If *general government debt* exceeds 60% of GDP, an assessment will also be made whether it will drop fast enough to the reference value of 60% of GDP.[17]

If countries implement structural reforms with positive effects on public finances in the long term, European fiscal rules are more flexible in application of the abovementioned rules.[18] In a Communication of 10 February 2015 the European Commission further operationalized these escape clauses.[19] The *structural reform clause* allows for a temporary deviation of the MTO (or the prescribed transition path in that direction), if a country implements structural reforms which could lead to additional costs in the short-term, but has positive budgetary consequences in the long-term. The *investment clause* allows for a comparable temporary deviation of the MTO (or the prescribed transition path) for expenditure on specific investment projects that contribute to an enlargement of the economic growth capacity of a country and for which co-financing is received from European funds.

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[15] Article 5(1) of Regulation (EU) 473/2013, in conjunction with section 1a, Article 2a of Regulation (EC) 1466/97, as amended in 2005 and 2011.

[16] Article 5(1) of Regulation (EC) 1466/97, as amended in 2005 and 2011.

[17] Article 5(1) of Regulation (EC) 1466/97, as amended in 2005 and 2011.

[18] Article 5 of Regulation (EC) 1466/97, and Article 2(1) of Regulation (EC) 1467/97.

[19] See EC, Making the best use of flexibility within the existing rules of the Stability and Growth Pact (COM(2015) 12 final/2), 10 February 2015, annex 2.

Aside from the two previously described specific escape clauses, the SGP provides a general escape clause which allows for a temporary deviation of (the transition path to) the MTO in two possible situations. The first situation involves a serious economic decline which affects the EU or Eurozone as a whole. The second situation involves the circumstance that a country is faced with an exceptional event with a major impact on its public finances. Whether that is the case, is assessed on a case-by-case basis. For example, at the end of 2015 it was decided that – under certain conditions – additional expenditure relating to the influx of refugees may be included in the considerations.[20] The Advisory Division points out that, should it be desired to make use of this, that this should be called for in the Stability Programme.[21] The government makes no mention of this in the Stability Programme. Therefore the Advisory Division, at this point in time, sees no reason to include the escape clauses in its report.

The European Commission assesses the budget of each individual financial year at three different moments in time: prior to the start of a financial year (*ex-ante*), during the year (*in year*) and after the a financial year has ended (*ex-post*). The *ex-post* assessment is important, since the Commission can establish on this basis whether there was a ‘significant deviation’, which could lead to the start of a formal ‘significant deviation procedure’. In the last instance, such a procedure could lead to sanctions. It's for this reason that the Advisory Division has paid separate attention in this report to development of public finances for the year 2015.[22]

In the opinion of the Advisory Division, a full assessment should also relate to *long-term sustainability* of public finances. Moreover, in its opinion, the assessment should include a *risk analysis.* Apparently exact figures create a false sense of certainty. This makes it desirable in reviews to pay attention to uncertainties and risks affecting both forecasts as well as analyses.

Furthermore it is appropriate in the assessments to monitor to what extent country-specific recommendations of the EU Council (ECOFIN Council) are complied with by the government in the area of budgetary policy.[23] Since the Netherlands did not get a country-specific recommendation in May 2015 for 2016 regarding budgetary policy, that part, however, will not be included in the

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[20] See EC, 2016 Annual Growth Survey: Strengthening the recovery and fostering convergence, 26 November 2015 (COM(2015) 690 final), page 13, as well as EC, Report on Public Finances in EMU 2015, European Economy Institutional Papers, no. 014, December 2015, footnote 52.

[21] This has been established in the Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes (‘Code of Conduct SGP’) of 3 September 2012, and elaborated further in EC, Vade Mecum on the Stability and Growth Pact, 2016 edition, European Economy Institutional Papers, no. 021, March 2016.

[22] It should be noted that for significant deviations a formal procedure can only be started based on the *ex-post* assessment by the European Commission. The *ex-ante* and *in year* assessments cannot lead to this.

[23] The Council can establish these recommendations on grounds of Article 5(2) of Regulation (EC) 1466/97, as amended in 2005 and 2011.

considerations of this report. In this respect the Advisory Division considers the government's policy response to the findings of the European Commission in respect of the two variables of macroeconomic imbalances that require closer consideration, specifically the major current account surplus and the high private debt ratio, as being important.[24] This will have to be evident from the 2016 National Reform Programme.

The Advisory Division assesses budgetary rules on the basis of information from CPB and the Ministry of Finance. In the 2016 CEP all projection information which is relevant to the review under budgetary rules is included in a separate section.[25] In this it must be noted that after the CEP publication, Statistics Netherlands published the first actual figures of public finances for the year 2015 on 25 March 2016. The effective budget deficit, based on these actual figures, is a fraction more favourable (rounded off 0.1pp of GDP) than CPB had kept account of in the 2016 CEP. In the actual figures government debt ends up more than 1.0pp of GDP lower. These (fractional) differences, however, do not lead to a different outcome of the review under European fiscal rules.

3.2 Assessment under European fiscal rules

Table 4 shows the data relevant for the review under European fiscal rules.

3.2.1 Ex-post assessment for the year 2015

Deficit development

Actual budget deficit in 2015 was 1.8% of GDP, according to Statistics Netherlands, which is 0.1pp more favourable than the 1.9% of GDP that CPB took account of in the CEP.[26] So, the actual budget deficit remained below the Maastricht reference value of 3% of GDP. That did not apply, however, for the structural budget deficit of 1.0% of GDP. The structural deficit exceeded the medium-term budgetary objective applicable in 2015 for the Netherlands of 0.5% of GDP.

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[24] See EC, 2016 Alert Mechanism Report, 26 November 2015 (COM(2015) 691 final) and EC, Country Report The Netherlands 2016, Including an in-depth review on the prevention and correction of macroeconomic imbalances, 26 February 2016 (SWD(2016) 87 final).

[25] CPB's 2016 Central Economic Plan, 21 March 2016, paragraph 3.2. See also W. Suyker, The 2016 CEP projections and European fiscal rules, CPB *Achtergronddocument* [Background document], 21 March 2016.

[26] See Statistics Netherlands, The Netherlands in 2015: An economic review, 25 March 2016, page 27. This fractionally better actual figure by Statistics Netherlands for the actual budget deficit of 2015, at the time of the 2016 CEP publication, was not known yet. An analysis by CPB shows, however, that the fractionally better figure has no influence on the outcomes of the review for the years 2015, 2016 and 2017 under European fiscal rules.

Table 4: Data on European fiscal rules

	2014	2015[a] *ex-post*	2016 *in year*	2017 *ex-ante*
Rule in respect of development of structural balance (% of GDP)				
General government balance (actual)	-2.4	-1.9	-1.7	-1.2
General government balance cyclical component	-1.7	-0.8	-0.4	0.0
One-off and other temporary measures	-0.1	0.0	0.3	0.0
General government structural balance (EC method)	-0.6	-1.0	-1.6	-1.2
Change in general government structural balance	0.2	-0.4	-0.6	0.4
Required budgetary effort (req. improvement in gen. gov.structural balance)[b]		-0.3	-0.2	0.6
Deviation		-0.1	-0.4	-0.2
Expenditure rule				
Adjusted net public expenditure (actual change in %)	-2.5	-0.6	1.2	1.0
Required budgetary effort (max. growth adjusted for net publ.exp.)	0.7	1.4	1.2	-0.7
Deviation	-3.2	-2.0	-0.1	1.7
Deviation (% of GDP)	-0.3	-0.9	0.0	0.7
Debt criterion (% of GDP)				
General government debt	68.2	66.3	65.4	64.1
Maximum debt based on debt criterion				65.9

Source: CPB, 2016 Central Economic Plan, table 3.2

(a) Statistics Netherlands published actual figures for 2015 on 25 March 2016. These were still unknown at the time of the CEP publication. For the sake of consistency, figures from the CEP are shown in this table for 2015. Differences between Statistics Netherlands and CPB are small and do not lead to a different outcome of the review under European fiscal rules.
(b) In the required budgetary effort for the structural balance, a positive sign should be read as the minimum required improvement of the structural deficit in % of GDP; a negative sign should be read as the maximum permitted deterioration of the structural deficit in % of GDP.

European fiscal rules, however, do not only place demands on the maximum value of the structural deficit, but also on development of the deficit. In the spring of the year prior to the fiscal year considered, the European Commission ‘freezes’ the required budgetary effort (see text box ‘The principle of freezing’). If later projections nonetheless imply a lesser required budgetary effort, then the lesser required effort applies. The latter is the case for 2015: in the Commission's 2015 Spring Forecast the structural budget balance for 2014 was –0.2% of GDP. For 2015, this allowed for some room of 0.3pp of GDP for the budget deficit to increase. This room for budgetary manoeuvre is relevant for assessment of the 2015 structural budget balance development.

The principle of 'freezing'

In order to offer Member States certainty on the required budgetary effort on which the Commission will assess the budget as early as possible, the required budgetary effort in the spring prior to the particular fiscal year is 'frozen' on the basis of the European Commission's spring forecast.

The principle of 'freezing' works as follows. The required budgetary effort for the structural balance for year *t* is determined in the spring of the year *t-1*, based on the forecast structural balance for the year *t-1*. The *ex-post* assessment in the spring of year *t+1* takes place on the realised development of the structural balance in the year *t*, assessed on the basis of the frozen required budgetary effort as determined on the basis of the spring forecast for the year *t-1*. For the expenditure rule this takes place in a similar manner.

There is one exception to the method of working as described above. If the structural balance for the year *t-1* appears in forecasts after the spring forecast *t-1* leads to a lesser required budgetary effort for the structural balance for the year *t*, then the lesser required budgetary effort applies. Vice versa this rule does not apply: new forecasts can never lead to a greater required budgetary effort than determined in the spring of year *t-1*.

This method of working was announced in March 2014 by the Commission, but was only described for the first time in a publicly accessible document in December 2015, and recently incorporated in an updated vade mecum.[27] The Advisory Division therefore placed a number of notes in its 2015 September Report.[28] Furthermore the Advisory Division noted that although the 'freezing' method could lead to the required budgetary effort being set for a given year, postponement of the required improvement would not lead to cancellation: the required budgetary effort is merely postponed to a year later.

The structural budget deficit deteriorated in 2015 by 0.4pp of GDP compared to the realised structural deficit for 2014 and ended up at −1.0% of GDP, particularly due to substantially reduced natural gas revenues. With this deterioration the development of the structural budget balance indeed deviates from the permitted margin of 0.3pp of GDP which is derived from the required budgetary effort, but this deviation is not 'significant'. There is a significant deviation, on grounds of the SGP, if development of the structural budget balance, calculated over one year deviates by at least 0.5pp of GDP (in a negative sense) from the required budgetary effort. Furthermore, a deviation is considered significant if there is a deviation over two years accumulatively of at least 0.5pp of GDP, or – in other words – if taken over an average period of two years, there is a deviation of 0.25pp of GDP or more per year.[29] With a deviation of 0.1pp of GDP in respect of the required budgetary effort, it can be concluded that there is no question of a significant deviation.

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[27] See EC, Vade Mecum on the Stability and Growth Pact: 2016 edition, European Economy Institutional Papers, no. 021, March 2016.

[28] Following on from remarks by the Advisory Division, in its report of November 2015, the Irish national budget supervising authority also placed an annotation regarding this method of working. See Irish Fiscal Advisory Council, Fiscal Assessment Report, November 2015, page 64.

[29] Article 6(3) of Regulation (EC) 1466/97, as amended in 2005 and 2011.

Development of expenditure
The expenditure rule sets a limit to the growth of public expenditure net of discretionary revenue measures. In addition, public expenditure is also corrected for the cyclical component of unemployment benefits expenditure and for interest expenditure. The maximum permitted growth of public expenditure is dependent on the distance of the structural balance to the medium-term budgetary objective. The corrected expenditure in 2015 was allowed to rise on grounds of the expenditure rule by a percentage that, in principle, corresponds with the projected trend growth, because the structural budget balance itself, in the most favourable forecast for 2015, was below the MTO. For Dutch public finances it implied a maximum permitted growth of corrected expenditure in 2015 of 1.4%. In reality – assuming CPB calculations – corrected expenditure fell by 0.6%. Thus the budget in 2015 generously complied *ex-post* to the expenditure rule.

Development of general government debt
The debt criterion determines that the general government debt must be lower than 60% of GDP or – when exceeding the reference value – in any case, shifts “to a sufficient degree” towards the reference value and “at a satisfactory pace”.[30] This is further concretised in a provision that general government debt must decrease every year by at least one-twentieth of the difference between the actual general government debt and the reference value, in which – described in brief – the average annual reduction is checked continuously over a period of three years.[31] For Member States, including the Netherlands, which still found itself in an excessive deficit procedure in 2011, however, a transition period for the debt rule applies for the subsequent three years after the year in which the actual deficit was brought below the reference value of 3% of GDP. The transition period for the debt rule therefore applies for 2015 because the Netherlands corrected its excessive deficit in 2013.

According to Statistics Netherlands, the general government debt at the end of 2015 is 65.1% of GDP.[32] That is a reduction of 3.1pp compared to the end of 2014. With this reduction, debt complies with the criterion applicable for the transition period.

Conclusion
Taking the three criteria in conjunction with each other into consideration, the Advisory Division concludes that Dutch public finances in 2015 did not fully comply with European fiscal rules. Although the expenditure rule and the debt criterion have been complied with, the structural budget balance exceeded the medium-term objective (MTO) applicable to the Netherlands in 2015, mainly as a result of reduced natural gas revenues. Moreover, development of the structural

30 Article 126, second paragraph, under b TFEU.
31 Article 2, paragraph 1a of Regulation (EC) no. 1467/97, as amended in 2005 and 2011.
32 See Statistics Netherlands, *Nederland in 2015: Een economisch overzicht* [The Netherlands in 2015: An economic review], 25 March 2016.

balance in 2015 deviated from the required budgetary effort, but this deviation does not qualify as significant. If the 2016 Spring Forecast of the European Commission shows identical outcomes, this will lead to a so-called overall assessment. Such an assessment will not, however, lead to the start of a formal significant deviation procedure for 2015, because there is no question of a significant deviation. The text box below explains this in more depth.

Assessment by the European Commission

The following matrix shows the possible outcomes for the rules in respect of development of the structural balance and the corrected net public expenditure respectively, as well as the consequence subsequently emanating in the correlation of both rules.

A deviation in (one of) the two rules always leads to a so-called 'overall assessment' by the European Commission. In such an assessment the Commission undertakes a further investigation into the underlying causes of a deviation. The overall assessment by the Commission can, however, only lead to the start of a significant deviation procedure if at least one of the two rules qualifies as a significant deviation.

Structural balance / Expenditure rule	Required adjustment realised	Deviation	'Significant' deviation
Expenditure rule upheld	Complied with	*'Overall assessment'* (cannot lead to formal procedure)	*'Overall assessment'* (can lead to formal procedure)
Deviation	*'Overall assessment'* (cannot lead to formal procedure)	*Overall assessment'* (cannot lead to formal procedure)	*Overall assessment'* (can lead to formal procedure)
'Significant' deviation	*Overall assessment'* (can lead to formal procedure)	*Overall assessment'* (can lead to formal procedure)	*Overall assessment'* with big chance of ascertaining significant deviation (can lead to formal procedure)

3.2.2 Assessment for the years 2016 and 2017

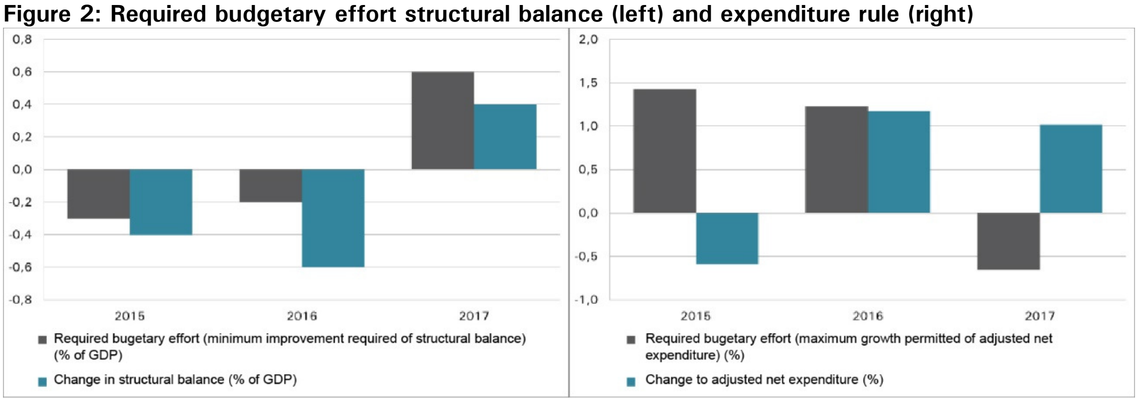
Deficit development

The actual budget deficit shows a further reduction in 2016 and 2017, respectively to 1.7% of GDP in 2016 and 1.2% of GDP in 2017. The actual deficit in these years will remain well below the 3% cap. The structural budget deficit, however, does not comply with European rules. The structural budget deficit increases in 2016 to –1.6% of GDP, to fall in 2017 to –1.2% of GDP. So, the structural deficit will be above the medium-term objective (MTO) in both years.

After the assessment of the Dutch budgetary plans for 2016 and adoption of the required budgetary effort by the European Commission in May last year, the government decided in the summer on a package of tax-relief measures worth € 5 billion. Furthermore, natural gas revenues fell short of expectations. In its

September Report, the Advisory Division noted that budgetary cover required for this would have to be dealt with in the budget preparation for the year 2017.[33] That now manifests itself: the structural budget deficit, according to current projections, is in excess of the medium-term budgetary objective of 0.5% of GDP in both years. In that case, according to European fiscal rules, a budgetary effort is required in the form of a minimum annual improvement of the structural budget balance. However, here too, the required budgetary effort is frozen in the spring prior to the year to which the budgetary effort relates. Therefore, for the required budgetary effort for the year 2016, the spring forecast of 2015 may still be assumed. Since the structural budget balance for 2015 in that forecast was still presumed to comply with the medium-term budgetary objective, a minor deterioration of the structural budget balance for 2016, by 0.2pp of GDP, is permitted (see figure 2, left). The deterioration of 0.6pp of GDP visible in the current CPB forecast of the 2016 structural balance compared to 2015 is, however, greater than permitted. The deviation of 0.4pp of GDP in respect of the required budgetary effort for 2016 does not qualify as 'significant'. The deviation is significant, however, for the average over the years 2015 and 2016 combined.

Figure 2: Required budgetary effort structural balance (left) and expenditure rule (right)



On the basis of current forecasts, pursuant to European fiscal rules, the structural balance would have to improve by at least 0.6pp in 2017 compared to 2016. In that respect the currently projected improvement of 0.4pp falls short. For 2017 it also applies that deviation of 0.2pp as seen over one year, is not significant, but that average deviation (0.3pp of GDP) over 2016 and 2017 together, when compared to the required improvement, is indeed significant.

<u>Development of expenditure</u>

The maximum permitted growth of corrected net public expenditure depends on the deviation of structural balance compared to the medium-term budgetary objective. Since the structural budget balance itself, in the most favourable forecast of the European Commission was below this objective, corrected expenditure based on the expenditure rule may rise by a percentage that is

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[33] September 2015 Budget Supervision Report, no. W06.15.0305/III/B, 14 September 2015 (appendix to Parliamentary Papers II 2015/16, 34 300, no. 3).

fractionally higher than the projected trend growth. For the Netherlands that implies a permitted growth of corrected expenditure in 2016 of a maximum of 1.2% (figure 2, right). According to the most recent CPB projections, development of expenditure in 2016 is exactly in line with this objective.

For 2017, however, that is different. Due to the forecast structural balance in 2016 no longer complying with the medium-term budgetary objective, the increase of corrected public expenditure based on European fiscal rules should lag behind the economic growth trend for the medium-term, or should be compensated by discretionary measures on the revenue side. For 2017 this translates into a required budgetary effort which implies that corrected net public expenditure must fall by 0.7% (approximately € 5 billion).[34] With the current rise of corrected expenditure of 1.0% envisaged for 2017, this rule is not complied with. This means that, both for 2017 alone as well as averaged over 2016 and 2017 together, it represents a significant deviation when this is related to the extent of GDP.

Development of general government debt

General government debt falls further in the years 2016 and 2017. For the end of 2016, CPB projects a debt of 65.4% of GDP and 64.1% of GDP at the end of 2017. However, these projections did not keep account of the actual figures by Statistics Netherlands over 2015, in which the debt already resulted in 65.1% of GDP. Nonetheless it may be assumed that development of general government debt both in 2016, which is the last year for which the transition period for the debt rule applies, as well as in 2017, complies with the required development of debt based on European fiscal rules.

[34] With expenditure cuts (or increases in the tax burden) of approximately € 5 billion the required budgetary effort for the expenditure rule is fully complied with in 2017. With expenditure cuts (or tax burden) of a minimum of approximately € 1.5 billion it represents a deviation in the required budgetary effort for expenditure in 2017, but this deviation is no longer significant. Then the deviation will also be ironed out in the structural balance and there will be one criterion with a non-significant deviation. Thus there is no chance of a formal significant deviation procedure (see text box 'Assessment by the European Commission'). These factors, however, also depend on possible additional decisions over the year 2016.

Volatility of required budgetary effort

Requirements in the context of the expenditure rule that are prescribed for the development of corrected public expenditure net of discretionary revenue measures (net public expenditure), are dependent on whether the structural budget balance is in line with the medium-term budgetary objective (MTO). If the structural budget balance complies with the MTO, then the rule applies that corrected net public expenditure may not rise faster than the projected economic growth trend for the medium-term. The percentage with which expenditure may rise at most, in that case, is therefore equal to the medium-term growth trend. The consequence is that public expenditure structurally stays in line with the size of the economy, so that the structural budget balance (which reads as a percentage of GDP) remains steady and therefore continues to comply with the MTO.

If the structural budget balance does not comply with the MTO, then the rule applies that corrected net public expenditure may rise slower than the projected economic growth trend for the medium-term. The growth rate at which expenditure may rise at most, in this case, is therefore a percentage that is lower than the medium-term growth trend. The difference between those two growth rates is called the ‘convergence margin’. The extent of the convergence margin depends on the required budgetary effort applicable to improvement of the structural balance: the further the structural budget balance deviates from the MTO, the higher the required improvement of structural balance and the greater the convergence margin. Moreover, the expenditure rule is symmetrical: if the structural deficit is below the MTO, then corrected expenditure may rise faster than the growth trend.

The aforegoing, in combination with volatility of the structural balance itself and implementation of freezing forecasts, explains why the required budgetary effort for the expenditure rule fluctuates so much between 2016 and 2017. The required budgetary effort for 2016 was frozen last spring. In the forecasts at that point in time the structural budget balance complied with the objective for the medium term. The package of € 5 billion tax-relief measures which the government decided on in the summer leads to a deterioration of the structural balance in 2016, which now results in a more difficult budgetary effort for the expenditure rule in 2017.

Conclusion

European fiscal rules look at development over both one and two years. For the assessment over one year the Advisory Division concludes that Dutch public finances based on CEP projections in 2016 and 2017 for the structural balance, do not comply with European fiscal rules. Deviation of the permitted deterioration (in 2016) or of the required improvement (in 2017) is short of being significant in the forecast. Furthermore, for 2017 the expenditure rule is also not be complied with, but here the deviation is significant. In addition, for both rules for 2017 deviations are significant in terms of European fiscal rules calculated over two years.[35]

[35] For the European Commission this could be a reason to implement an overall assessment and on that basis, to advise the Council to direct one or more country-specific recommendations in respect of the budget towards the Dutch government. Such matters also depend on the 2016 spring forecast which the European Commission will publish at the beginning of May.

Table 5 again shows a summarized result of the review under European fiscal rules.

Table 5: Summarized result of European fiscal rules review (based on 2016 CEP)

	2015	2016	2017
Structural balance	×	✘	✘
Expenditure rule	✓	✓	✘
Public debt	✓	✓	✓

Explanatory note on signs used:

✓ : compliance with the relevant rule

× : there is a deviation from the rule, but the deviation is not significant

✘ : there is a deviation from the rule and, calculated over a 1 and/or 2-year average, the deviation is significant

3.2.3 A glance at the years after 2017

In the medium-term forecast, CPB also identified how the projected development of public finances relate to European fiscal rules. A positive actual budget balance is projected as from 2019. If there is no change in policy, then from 2019 the structural budget deficit will also be less than 0.5% of GDP, which would comply with the objective. The expenditure rule will also be complied with as from that year. In 2019 the general government debt will be below the European threshold of 60% of GDP. For 2021 a minor structural surplus is projected and a general government debt of 54% of GDP. These outcomes are based on the assumption that the room for budgetary manoeuvre is used in favour of the budget balance and not used for additional tax-relief measures or increased expenditure.

3.3 National budgetary rules

The Advisory Division finds that in the Stability Programme the government states it will adhere to the regular national budgetary framework.[36] This regular national budgetary framework focuses on maintaining the so-called revenue and expenditure ceilings. The government states in the Stability Programme that with this, the Netherlands would remain within permitted margins of European fiscal rules under the preventive arm of the SGP. This makes it appropriate also to include national rules with regard to the expenditure ceiling and the revenue ceiling in the assessment.[37]

The national methodology of expenditure ceilings maximizes the expenditure total for every individual year of the government term, differentiated in three separate ceilings for respectively the social security expenses, healthcare expenses, and all

[36] 2016 Stability Programme, page 3.

[37] This is also provided for in Article 5 of Regulation (EU) 473/2013, in which tasks are described (but not limited at any rate) of the national supervisory body. The second paragraph of this article calls for drawing up publicly accessible assessments, where appropriate, with regard to national budgetary rules. In addition, national budgetary rules that are provided for in the Sustainability of Public Finances Act, have also been given a legal basis.

other expenditure (State budget (narrow definition)). For the revenue side of the budget, a so-called revenue ceiling is set for the total policy-related tax development (increases in the tax burden or alternatively tax relief) for the full government term. Cumulative over the full government term this revenue ceiling must be complied with, but unlike the expenditure ceiling, this does not apply for each individual year of the government term. National budgetary rules envisage providing calm in the policy and budget process by establishing the expenditure ceiling and revenue ceiling for the full government term at the start, assuming a certain objective and constraints with regard to the budget deficit. This nonetheless means that tensions could arise with European fiscal rules which place restrictions on the (year-on-year) development of the structural balance, on corrected net public expenditure, and on general government debt, and in so doing could change year-on-year during the government term.

The 2016 CEP projects an overspending of the expenditure ceiling by € 1.7 billion in 2016 and € 2.7 billion in 2017 (see table 6), which is mainly caused by the fact that expenditure ceilings are indexed by a lower percentage than the upward pressure arising from specific wage and price adjustments of public expenditure (‘terms of trade loss’). The pronouncement by government in the Stability Programme to adhere to the expenditure ceiling therefore implies that – assuming CPB forecasts of mid-March – additional measures will be needed amounting to € 1.7 billion respectively € 2.7 billion (of course these amounts are subject to readjustment based on current data).

Table 6: Data national budgetary rules

(€ billion)		2016	2017	cum. 2013-2017
Expenditure ceiling				
Exceeding		1.7	2.7	
of which	*State budget (narrow definition)*	*3.4*	*5.1*	
	Social security and Labour market policy	*-0.5*	*-0.9*	
	Healthcare	*-1.2*	*-1.6*	
Revenue ceiling				
Exceeding		-0.5	-0.6	*-1.2*
of which	*policy changes (excl. healthcare)*	*0,0*	*0,0*	*0,0*
	healthcare	*-0.5*	*-0.6*	*-1.2*

Source: CPB, 2016 Central Economic Plan, tables 3.3 and 3.4

The Stability Programme shows that in recent years an overspending of the expenditure ceiling projected in the CEP for the fiscal year at hand have been eliminated in the Budget Memorandum by policy measures, amongst other things.[38] It should be noted, however, that overspending projected in the CEP was less than € 1 billion, and that overspending projected in the 2012 CEP for 2013 also called for a substantial package of additional measures (€ 6 billion). This

[38] 2016 Stability Programme, figure 3.1.

suggests that in the coming months another considerable policy effort is required to get the overspending projected in the CEP to disappear from the books.

If the revenue ceiling must balance over the full government term, as the government expresses its intention in the Stability Programme, that would also mean, given the current room of € 1.2 billion in the revenue ceiling, that the government would have to take tax burdening measures of that magnitude in 2017.

If both the expenditure ceiling and the revenue ceiling are indeed adhered to, this will have a positive impact on the structural balance. In that case it is expected that there will no longer be (significant) deviations from the required budgetary effort for both development of the structural balance and for expenditure following from European fiscal rules. The Advisory Division notes that this implies that if the government adheres to national budgetary rules and – on the basis of the CEP – would therefore be taking measures of € 1.7 billion for 2016 and cumulatively € 3.9 billion for 2017, it is expected that there is no longer a significant deviation in respect of European fiscal rules. At the same time the Advisory Division notes that in the Stability Programme, the government offers no insight about how it aims in concrete terms to fulfil its commitment to budgetary rules, which does not make it possible to express an opinion on it at this time.

3.4 Sustainability of public finances in the long-term

Every three years the medium-term budgetary objective of budgetary policy is brought up to date and derived from long-term sustainability analyses. This increases the necessity to not only include development in the medium term (MTO) into the considerations, but also long-term sustainability of public finances.

The objective of structural balance in the budget in the medium-term is derived from the desirability to be able to absorb shocks from cyclical setbacks in the budget balance, and from the desirability to have sustainable public finances in the long-term in a society with an ageing population. Public finances are 'sustainable', if future tax revenues are sufficient to offer future generations inflation-proof public services and to be able to pay interest expenditure without the general government debt continually increasing and thus becoming unsustainable in the long-term. This is expressed in the so-called 'sustainability balance'.

Since 2010 measures have been taken in the area of healthcare, pensions and social security, to make institutions and arrangements more future-proof. In 2010 CPB calculated a so-called sustainability gap of 4.5% of GDP for the long-term.[39] By the middle of 2014 CPB published a new sustainability study in which measures taken in the last government term were processed.[40] That resulted in a far more positive outlook of the long-term sustainability of public finances: the

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[39] CPB, *Vergrijzing verdeeld: Toekomst van de Nederlandse overheidsfinanciën* [Ageing: Future of Dutch public finances], 1 June 2010.

[40] CPB, *Minder zorg om vergrijzing* [Less concern about ageing], 3 July 2014.

deficit in the new study had reversed into a sustainability surplus of 0.4% of GDP (approximately € 2.6 billion) in the long-term, on the proviso that the assumptions on which these analyses were based, will be complied with. In the recent medium-term forecast, CPB reiterated this projection. Even after processing the package of tax-relief measures of € 5 billion in 2016, this still results in a sustainability surplus which calculates to an even higher percentage than in 2014 (0.7% of GDP).

These types of long-term analyses, however useful, unavoidably are subject to many uncertainties, as CPB also points out. This mainly plays a part in respect of the development of future healthcare expenditure, in which CPB keeps account of a further relative growth after 2021.

3.5 Uncertainties and risks

In the Advisory Division's opinion, it nonetheless remains of importance to pay attention in its reports to uncertainties that are unavoidably encompassed in forecasts and analyses and risks which that entails for supervising budgetary policy. In concrete terms, in its medium-term forecast CPB also mentions developments in the European Union (the possibility of a new debt crisis, a possible Brexit, and a suspension of the Schengen Agreement for a longer time), a persistent terrorist threat, uncertainty about monetary policy in Europe and USA, a possible 'hard landing' of the Chinese economy and developments in financial markets.[41]

Uncertainties in the forecasts are illustrated by CPB using so-called 'fan charts', in which forecasts for key variables such as growth, unemployment and the budget deficit are provided with margins of uncertainty and the chances with which these margins can occur. These show, for example, that despite a further improvement of the budget deficit, for a forecast budget deficit of 1.2% of GDP in 2017 there is a chance of more than 20% that the deficit will be higher than 3% of GDP in 2017.[42] Forecasts of the structural budget deficit also have a large margin of uncertainty.[43]

By taking adequate measures now to comply with European fiscal rules, there will be greater (budgetary) scope for considering new societal challenges on the one hand, and the creation of desirable room for budgetary manoeuvre in more difficult

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[41] CPB, *Middellangetermijnverkenning 2018-2021* [Medium-term Outlook 2018-2021], 30 March 2016, page 6.

[42] CPB's 2016 Central Economic Plan, 21 March 2016, page 31.

[43] The absolute forecasting error of the structural balance for the coming year over the period 2007-2013 for the Netherlands amounted to an average of 0.5% of GDP, which is equal to the requested annual improvement of this balance required in the preventive arm (see J. Hers and W. Suyker, Structural budget balance: A love at first sight turned sour, CPB Policy Brief no. 2014/07, 21 October 2014, page. 11). This likewise also applies for many other EU countries and seen over a longer period (see G. Claeys, Z. Darvas and Á. Leandro, A proposal to revive the European Fiscal Framework, Bruegel Policy Contribution, no. 2016/07, March 2016).

years on the other in the future. Uncertainties give an indication of the importance of having sufficient room for budgetary manoeuvre in the budgetary policy.

This is all the more important since experience has shown that policy measures flesh out in a pro-cyclical fashion in many cases: since the year 2000, Dutch budgetary policy has been pro-cyclical for seven years, counter-cyclical for three years and cyclical-neutral for six years.[44] In other OECD countries this is not effectively different.[45] Countries with a budget surplus and a limited general government debt often appear to have carried out counter-cyclical policy. Reaching the budget balance cap (–3% of GDP) more often, means that budgetary rules necessitate pro-cyclical policy. That was the case in the Netherlands, for example, in 2004/2005 and in 2012/2013.

Moreover, in the past fifteen years there has been major volatility in the Dutch budget balance: budget surplusses at the beginning of this century and prior to the financial crisis proved to reverse rapidly in deficits of more than 3% of GDP, with the start of an excessive deficit procedure as a consequence.[46]

Also in an international perspective, the Dutch budget balance is relatively volatile. A recent study by DNB shows that, from an international point of view, relatively large balance sheets of Dutch households – with relatively high debts on the one hand, but also many assets on the other – exacerbates macroeconomic volatility and via this route also volatility of public finances.[47] Reforms in the area of pensions and housing financing can help to reduce these causes, but because of generally long transitional periods they effectively have very gradual consequences and are therefore a long-term process. The maintaining of sufficient room for budgetary manoeuvre in the budget balance respectively the reaching of a higher growth path continue to be appropriate.

In light of the aforegoing the Advisory Division further notes that forecasts for the budget balance and general government debt as outlined in CPB's recent medium-term forecast could suggest that measures to comply with budgetary rules in 2016 and 2017 could be of a temporary nature. However, the Advisory Division again points to major international uncertainties and their related consequences in

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[44] W. Suyker, *Opties voor begrotingsbeleid* [Options for budgetary policy], CPB Policy Brief no. 2016/02, 2 March 2016.

[45] B. Égert, Fiscal Policy Reaction to the Cycle in the OECD: Pro- or Counter-cyclical?, Economics Department Working Papers, no. 763, May 2010.

[46] This is underlined by a recent CPB study, which shows that for a budget deficit of 1% of GDP in the base year, there is a 28% chance that during the subsequent government term, the cap for the deficit of 3% of GDP will be exceeded. For a lower deficit or a budget surplus the chance of this, however, drops substantially. For a surplus of 1% of GDP of the budget at the beginning of the government term, the chance of exceeding the 3% reference value for example, is four times smaller.

[47] J. Parlevliet and T. Kooiman, *De vermogensopbouw van huishoudens: is het beleid in balans?* [Capital formation of households: Is the policy balanced?], DNB Occasional Studies, no. 13-1, 2015.

forecasts. Besides, current uncertainties imply risks which, according to CPB, are often downward in nature. Quantified margins of uncertainty surrounding economic growth forecasts of 1.8%, imply that there is a 67% chance of economic growth between 1.0% and 2.6%.[48] Furthermore, the Advisory Division points out the assumption of unchanged policy on which forecasts for the budget balance and the general government debt are based. The resulting picture (which in the period 2018-2021 concerns an increase in the tax burden, an ultimately constant purchasing power for households and no room for additional expenditure on, for example, security, education, research, infrastructure or sustainable development) could socially and politically lead to further deliberations, which could reduce the outlined budget surplus for the year 2021.

[48] See footnote 12.

4. Response from the government

On 8 April 2016 the Minister of Finance submitted a (written) response on behalf of the government on the draft assessment of the Advisory Division. The following is a (comprehensive) point by point outline of the response.

- In respect of the year 2015 the government endorses the assessment of the Advisory Division. The benchmark for the expenditure rule and the debt criterion have easily been met and the development of the structural general government balance has also remained within permitted margins.
- The government notes that for the years 2016 and 2017, the decision-making process on the budget is now taking place. Of course the assessment by the Advisory Division will be included in considerations in this procedure. It is with good reason that the Advisory Division notes that the decision-making process uses an overspending of the expenditure ceiling as the starting point based on CEP forecasts. This starting point calls for an extra effort on the government's part. This was also the situation in the past year and the regular national budgetary framework was applied successfully. While drafting the budget for 2017, maintaining the regular budgetary framework continues to be the starting point. The efforts by the government are focused on adhering to the expenditure and revenue ceilings. By implementing the regular national budgetary framework, the Netherlands will remain within the margins of European budgetary agreements.
- The government shares the Advisory Division's opinion that it is wise to create sufficient room for budgetary manoeuvre in the general government balance in prosperous times, in order to absorb cyclical shocks. CPB's medium-term forecast (MLT) shows that measures taken by government to get public finances in order, lead to a positive result. At the same time and with good reason CPB and the Advisory Division point out downward risks in the forecasts. In light of that, the recommendation from the Study Group on Fiscal Policy (SBR) is relevant. Prior to the election of the Lower House the SBR, by tradition, submits a recommendation on budget policy and budgetary objectives for the coming government term. The recommendation by the SBR is based on the MLT of CPB. The recommendation of the SBR is expected before the summer of 2016.
- The government appreciates the attention demanded by the Advisory Division for sustainable and sound public finances in the long-term. From the analysis by the Advisory Division it appears that structural reforms introduced in recent years in, for example, social security have led to an improvement of long-term sustainability of public finances. It is with good reason that the Advisory Division points to increased healthcare expenditure in the MLT of CPB. The government shares the Advisory Division's perception that ongoing attention is required for long-term sustainability of public finances.

5. Assessment

In light of the findings and conclusions in the preceding analysis, as well as response from the government on the draft assessment, the Advisory Division of the Council of State assesses the following.

1. The Advisory Division concludes that the Dutch budget, based on projections in the 2016 CEP, in the ex-post review for the budget year 2015, did not fully comply with European fiscal rules. Though the expenditure rule and debt criterion were complied with in 2015, the structural budget deficit exceeded the medium-term budgetary objective of 0.5% of GDP applicable to the Netherlands in 2015. The deterioration of the structural balance, moreover, was somewhat greater than permitted, but due to its limited extent this deviation does not qualify as a significant deviation.

2. European fiscal rules look at development over both one and two years. For the assessment over one year the Advisory Division concludes that Dutch public finances based on CEP projections in 2016 and 2017 for the structural balance, do not comply with European fiscal rules. Deviation of the permitted deterioration (in 2016) or of the required improvement (in 2017) is short of being significant in the forecast. Furthermore, for 2017 the expenditure rule is also not be complied with, but here the deviation is significant. In addition, for both rules for 2017 deviations are significant in terms of European fiscal rules calculated over two years. Without having specifically drawn up policy measures, the Netherlands runs the risk this spring of getting a country-specific recommendation regarding budgetary policy.

   Observed deviations in 2017 are (also) related to the fact that European fiscal rules for that year lead to a substantial budgetary effort as a result of – not covered in the 2016 budget – loss of natural gas revenues and the package of tax-relief measures of € 5 billion. In its September Report the Advisory Division has already pointed out that this would burden budget preparation for 2017 substantially, due to the (as a result of the freezing principle, delayed) effects of deterioration of the structural balance. That now manifests itself: the structural budget deficit, according to current projections in both years, is in excess of the medium-term budgetary objective of 0.5% of GDP. In that case, according to European fiscal rules, a required budgetary effort will apply in the form of a minimum annual improvement of the structural budget balance and reduced net public expenditure.

3. The Advisory Division ascertains that the government has fully committed itself in the Stability Programme to European budgetary agreements and intends to adhere to the regular (national) budgetary framework. The latter would, on the basis of the CEP, imply that the government would have to reduce spending in 2017 by € 2.7 billion and would have to increase taxes in that year by € 1.2 billion (these amounts are subject to readjustment based on the latest information). Since the government provides no insight in the

Stability Programme about how to accomplish its commitment in its own national budgetary framework in a concrete manner, the Advisory Division cannot, for the time being, express any opinion yet on the matter. However, the Advisory Division points out that if government indeed fully complies with national budgetary rules, there is probably no longer a question of significant deviations with regard to European rules. The information in the Stability Programme over the past period suggests that a considerable policy effort is still needed in the months ahead. For the sake of completeness the Advisory Division notes that the government does not make use of existing escape clauses in the Stability and Growth Pact.

4. The Advisory Division has established that current forecasts are surrounded by a relatively significant number of (international) uncertainties. According to CPB, risks for the forecasts are mainly downwards. In addition, Dutch public finances are relatively sensitive to cyclical shocks. The Advisory Division also points out that development of public finances for the period 2018-2021 as outlined in CPB's projections, are based on a number of assumptions regarding the development of the economy, and general government expenditures and revenues which are surrounded by many uncertainties. The uncertainties regarding international development are relatively significant and forecasts for public finances are based on the assumption of unchanged policy. Given the many uncertainties and policy assumptions used, in the Advisory Division's opinion, therefore, it may not automatically be assumed that development of the public finances outlined in the forecast will be realised.

   By taking adequate measures now to comply with European fiscal rules, there will be greater (budgetary) scope for considering new societal challenges on the one hand, and the creation of desirable room for budgetary manoeuvre in more difficult years on the other in the future. Uncertainties give an indication of the importance of having sufficient room for budgetary manoeuvre in the budgetary policy, according to the Advisory Division.

The Vice-President of the Council of State,

[signed]

J.P.H. Donner