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From:	Johan Barnard, Financial Counsellor, Permanent Representation of The Kingdom of The Netherlands to the EU
date of receipt:	8 May 2014
To:	Carsten Pillath, Director-General, DGG-Economic Affairs and Competitiveness General Secretariat of the Council of the European Union
Subject:	Stability Programme of the Netherlands - 2014

Delegations will find attached the second part of Stability Programme of the Netherlands - 2014

Chapter 5: Sensitivity analysis and comparison with previous update

Compared to the Stability Programme 2013, economic developments in 2013 turned out worse at -0.8 percent of GDP than previously forecast (-0.5 percent of GDP). The same applies to 2014, with the added observation that growth is no longer expected to be negative. However, due to the measures taken, the budget deficit is lower for both years and will consistently be under the threshold of 3 percent of GDP. Government debt is adjusted downwards for 2014 compared to the previous version of the Stability Programme.

Introduction

This chapter describes how a number of macro-economic core variables differ compared to the previous update of the Stability Programme. This is followed by an analysis of how these variables develop in alternative scenarios.

Comparison with Stability Programme of April 2013

As table 5.1 shows, GDP growth for 2013 to 2015 is lower than assumed in the previous Stability Programme. The effect of the lower GDP growth forecast on the budget deficit is, however, compensated for by the effect of the measures taken in the Coalition Agreement and the so-called 6 billion euro package. Compared to the previous update, the deficit is lower than forecast for 2013 and 2014. The development of the government debt is also revised downwards for 2014.

Table 5.1 Differences compared to the Stability Programme of April 2013

in percentages of GDP	**ESA Code**	**2013**	**2014**	**2015**
Actual growth in GDP				
Update April '13		-0.5	1.0	1.6**
Current update		-0.8	0.8	1.2
Difference		-0.3	-0.2	-0.4
Budget deficit	EDP B.9			
Update April '13		3.4	3.0	1.8**
Current update		2.5*	2.9	2.1
Difference		-0.9	-0.1	0.3
Government debt				
Update April '13		74.0	75.0	71.4**
Current update		73.5	74.6	74.7
Difference		-0.5	-0.4	3.3

* This number does not take any account of effects on the government balance sheet of the nationalisation of the SNS Bank. As a result, based upon currently available information, there is an upward risk of at most 0.3 percentage points.

**2012 Position in Initial Policy Document (Coalition Agreement)

Source: CBS, CPB and Stability Programme 2013.

Alternative scenarios and risks

Given the openness and the relatively limited size of the Dutch economy, the main risks with regard to the baseline scenario come from international developments, primarily via world trade. Recently, political developments in the Ukraine in particular have provided an additional uncertain element. Possible economic risks relate not only to world trade, but also to energy prices. This sensitivity analysis therefore presents the possible effects of a slowdown in relevant world trade and increasing energy prices. Both scenarios assume a change in variables at the start of 2014,

and then present the effects for the period 2014-2015. The scenarios are drawn up based on the most recent versions of NiGEM and SAFFIER[5].

Scenario 1: Delayed recovery of the global economy and world trade

The global economic recovery and world trade may end up being weaker than expected as a consequence of, for example, a slower recovery in consumer and producer confidence, the effects of tapering of monetary policy in the US or possible new financial turmoil in the European Union. Table 5.2 presents the effects of a fall in spending of 1 percent in 2014 of key trading partners Japan, US, United Kingdom, Belgium, Germany and France. This impulse would cause expected growth in relevant world trade to decrease by 1.9 percentage points in 2014. It would decline further in 2015 by 1.6 percentage points. The decrease in world trade would have a negative impact on Dutch exports. The prospects for the private sector would worsen due to lower exports and this, in turn, would result in lower investments, rising unemployment and an ensuing reduction in consumption. Lower VAT receipts, in combination with an increase in unemployment benefits, would result in a deterioration of the budget balance in this scenario. For the Netherlands a shock in world trade has a major downward effect on the budget balance. In this scenario the budget balance is projected at -3.1 percent in 2014 and -2.5 percent in 2015.

Scenario 2: Higher energy prices

In addition to a negative effect on world trade, the unrest in the Ukraine and political tensions with Russia could drive up oil and gas prices. Table 5.2 presents a scenario in which the energy prices are 10 percent higher than expected for a period of two years. Higher energy prices will push up inflation and drive down international spending and world trade. Investments, employment, consumption and the budget balance will worsen via the private sector. The effects of the economic downturn on the EMU balance are offset by higher gas revenue; the overall effect is marginally positive for 2014 and neutral for 2015. In this scenario the budget balance is projected at -2.7 percent in 2014 and -2.1 percent in 2015.

Table 5.4 Alternative scenarios

Deviation from baseline scenario (percentage point)	1. Fall in spending of trading partners		2. Higher energy prices	
	2014	2015	2014	2015
Volume of world trade (excl. energy)	-1.9	-1.6	-0.6	-1.2
Competitors' price (excl. energy)	-0.1	-0.7	0.4	0.9
Import price of goods	-0.2	-0.5	1.9	2.2
GDP (market prices)	-0.5	-0.6	-0.2	-0.5
Household consumption	-0.1	-0.3	-0.1	-0.3
Investments	-0.9	-2.2	-0.1	-1.4
Exports of goods and services	-1.5	-1.3	-0.4	-1.0
Imports of goods and services	-1.3	-1.3	-0.4	-1.0
Market sector production	-0.7	-0.8	-0.2	-0.7
Employment (years of employment)	-0.2	-0.5	-0.1	-0.3
Unemployment rate (percentage)	0.1	0.4	0.0	0.2
Market sector negotiated wages	-0.2	-1.0	0.2	0.2
Consumer price index (CPI)	-0.1	-0.4	0.3	0.6
EMU balance (% GDP)	-0.2	-0.4	0.2	0.0

1: Assumes a loss of spending power of 1 percent in 2014 affecting Japan, US, United Kingdom, Belgium, Germany and France.
2: Assumes 10 percent higher energy prices in 2014 and 2015.

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[5] See also CEP 2014. NiGEM is a model of the global economy produced by the National Institute of Economic Research. Saffier is the model used by the CPB for short-term projections, medium to long-term scenarios and analyses of Coalition Agreements and policy options.

Chapter 6: Sustainability of public finances

During the past few years various measures have been taken to improve the long-term sustainability of public finances. According to the most recent analysis by the CPB, the Netherlands currently has a positive sustainability balance of 1.0 percent GDP[6]. According to the calculations performed by the European Commission, the Netherlands has a sustainability gap of 5.9 percent GDP[7]. This considerable discrepancy is caused by differences in policy assumptions and calculation method. Both the CPB and the European Commission demonstrate an improvement in the sustainability of public finances, with the increase in pension age and the linking of the state pension age to life expectancy being the most significant contributing factors. Government guarantees, which have increased significantly since 2008 as a consequence of the financial crisis, are now being scaled down. As regards new guarantees, a strict 'no, unless' policy has been included in the fiscal rules.

Introduction

This chapter discusses the definition of the sustainability gap and the projections for public finances up to 2060. It also clarifies the differences between the CPB estimates and the winter forecast by the European Commission. Lastly, an overview is provided of the contingent liabilities of the Dutch government.

The sustainability balance

The sustainability balance reflects the future resilience of Dutch public finances. Public finances are regarded as sustainable if future income is sufficient to pay for future expenditure, including the interest on the existing debt. If this is not the case, public debt will become uncontrollable at a certain point in time. The sustainability balance reflects the difference between the budget balance actually expected at the end of the government's term in office and the minimum budget balance at which public finances are sustainable[8].

The sustainability calculations are not a projection of the most realistic scenario. The principal aim of these calculations is to assess whether current policy can be continued into the distant future. One thing is key: the assumption of constant arrangements. The term 'constant arrangements' means that the expenditure on, for example, health care or education per person as a proportion of income remains constant over time. In short, this means that each generation spends an equal amount of its income on health care and education.

The sustainability of Dutch public finances and the sustainability balance are affected primarily by demographic developments. The ratio of retired to working people is set to increase significantly in the period up to 2040. As a result, age-related expenditure on state pension (AOW) and healthcare will increase significantly faster than revenue. It is therefore important for policy to focus on making collective arrangements future-proof. Without this policy, budget deficits and the national debt will become uncontrollable in the future.

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[6] CPB, Update analysis of the economic effects on the Coalition Agreement financial framework (12 November 2012)

[7] European Commission, Fiscal Sustainability Report 2012.

[8] This figure is determined by a technical assumption that the collective arrangements in 2017 will be adapted in one go so that in the future – despite ageing – no additional adaptations will be necessary. These more cautious arrangements therefore apply for both current and future generations.

Table 6.1 Development of sustainability balance [9]

	as percentage of GDP	in billions of euros
Sustainability June 2010 CPB Ageing divided	-4.5	-29
Rutte 1 policy, pension agreement and economic situation	*1.9*	*11*
Sustainability CEP 2012	-2.6	-17
improvement in sustainability through 2013 Budgetary Agreement	*1.8*	*12*
economic situation	*-0.3*	*-2*
Sustainability including Budgetary Agreement *(June 2012)*	-1.1	-7
worsening of budgetary situation	*-0.2*	*-1*
Sustainability of Financial Framework baseline (*Oct 2012*)	-1.3	-9
improvement of sustainability of financial framework	*2.3*	*15*
of which State and other pensions	*0.2*	*1*
housing market	*0.3*	*2*
health care	*1.3*	*9*
other	*0.5*	*3*
Position including Coalition Agreement improvement	**1.0**	**7**

The most recent estimate of the Dutch sustainability balance dates from November 2012. This analysis takes account of the Coalition Agreement. The Rutte-Asscher Coalition Agreement contained various measures to improve sustainability and it has resulted in an improvement of 2.3 percent. This is mainly due to health care related measures, contributing 1.3 percentage points towards a more positive sustainability balance. Policy focussing on State and other pensions, the housing market and the other deficit-reducing measures account for the other 1.0 percent improvement. The Coalition Agreement builds on the 2013 budgetary agreement, which already contained the important State pension reforms and previous policy by the Rutte-Verhagen government aimed at improving the sustainability of government expenditure (see Table 6.1).

Projections until 2060

Table 6.2 provides an overview of the most recent projection by the CPB. This projection dates from November 2012 and therefore does not take any account of later measures such as the 2014 budgetary agreement. Neither does it include the most recent demographic projections by CBS. The estimate by the European Commission (from 2012[10]) differs considerably from the CPB estimate by calculating a sustainability balance of -5.9 percent. Policy weighting is the most important factor behind this significant difference: the CPB's sustainability calculation takes account of all government policies up to and including 2017. The European Commission only includes current policy in the calculation insofar as it has already been implemented and has been reflected in an improved budget balance or has been laid down in law. In the meantime a large number of the relevant measures have already been agreed. The two bodies use a different technique and different sources. The European Commission uses Eurostat as a source for the population forecast, while the CPB uses the forecast by CBS. The assumptions concerning the development of indirect tax revenue also differ: the CPB forecasts an increase, while the European Commission expects no change. Lastly, the initial budget position also differs to some extent. The CPB forecasts a certain

[9] This connecting table follows from the CPB memorandum of 19 June 2012 - *Further analysis of sustainability gains and balance objective for the next government's term in office-* and the CPB memorandum of 29 October 2012 - *Analysis of the effects of the Coalition Agreement's financial framework.*

[10] European Commission, 2012, *Fiscal Sustainability Report 2012*, European Economy 8/2012.

degree of recovery growth after 2017, which will lead to an improvement in the sustainability of public finances.

Table 6.2 Projection of public finances as estimated by the CPB

in percentage of GDP	2010	2020	2030	2040	2050	2060
Total expenditure	51.0	47.2	48.5	50.3	49.9	49.4
Of which: Age-related expenditure	20.5	21.8	23.7	26	25.9	25.5
Pension expenditure	6.9	7.4	8	8.9	8.7	8.5
Social security expenditure	12.6	13.1	13.8	14.6	14.4	14.2
Old age and early retirement pension	4.9	5.7	6.3	7.2	7	6.8
Other pensions (invalidity, surviving relatives)	2.0	1.7	1.7	1.7	1.7	1.7
Occupational pensions						
Health care	6.3	7.5	8.2	8.6	8.5	8.4
Long-term care	3.8	3.5	4.3	5.1	5.4	5.4
Education expenditure	5.5	5.1	5	5.1	5.1	5.0
Assumptions						
Growth in labour productivity	2.0	1.5	1.5	1.5	1.5	1.5
Actual growth of GDP	1.6	1.5	1	1.6	1.6	1.5
Participation rate men (age 15-64)	80.5	81.4	81.4	81.6	81.7	81.7
Participation rate women (age 15–64)	61.4	64.4	65.4	67.1	68.1	68.1
Total participation rate (age 15–64)	71.0	72.9	73.4	74.3	75.0	75.0
Unemployment (20-64)	5.5	3.4	3.4	3.4	3.4	3.4
Population of people aged 65+ compared to total population (%)	15.7	19.1	20.5	22.2	22	21.3

Contingent liabilities

The number of guarantees has significantly increased in recent years. Notwithstanding the reservations that the government has about providing fresh guarantees, measures were necessary to counter substantial systemic risks, both national and in the Eurozone. In 2013, a decrease was seen again for the first time, partly as a consequence of the lowering of the ceiling on the guarantee issued by the Dutch government to the temporary European Financial Stability Facility (EFSF). This lowering is the consequence of the entry into force of the European Stability Mechanism (ESM).

The decrease in the guarantee issued to the EFSF is partly offset by a new guarantee to the Dutch Central Bank (De Nederlandsche Bank, DNB) in the amount of 5.7 billion euros. Within the framework of the common monetary policy in the Eurozone, the central banks of the Euro system conduct monetary policy transactions with counterparties. As a consequence of the ECB's unconventional monetary policy, DNB's exposure has increased, as have the associated financial risks. The guarantee applies for a five-year period, but is extended in the event that DNB is exposed to a risk that cannot be absorbed with its own equity capital. Without the State guarantee, DNB would have been compelled to take a provision, which would have resulted in a lower profit distribution to the State.

Another new arrangement is the guarantee for the real estate management organisation set up during the nationalisation of SNS Reaal. During the nationalisation of SNS Reaal it was decided to transfer the real estate portfolio of SNS Reaal into a separate real estate management

organisation, with the purpose of winding down this real estate portfolio as efficiently as possible. However, this real estate management organisation first had to become the owner of the real estate portfolio by purchasing it from SNS Reaal. To this end, the organisation is expected to acquire financing using a State guarantee. The winding down of the real estate portfolio will lead to a reduction in the outstanding financing, and with that also the guaranteed amount.

Lastly, it should be mentioned that the guarantee scheme for interbank loans will end in 2014. This scheme was set up in 2008 to stimulate credit lending between banks. The phasing out of this scheme began in 2011 by, in first instance, making the conditions under which the banks could obtain such a guarantee from the government less attractive. The service desk for new loans was also closed in December 2010. This led to a rapid decrease in the risk for the government. While the government guarantee stood at 47.1 billion euros in 2009, the last guaranteed loan will expire in 2014. Because the last contract expires in November 2014, the guarantee will only be fully entered up in December 2014 in the budget and the guarantee overview. This will be visible in the budget for 2015. To date, the government has not suffered any loss or damage via this scheme.

The most recent overview (September 2013) is shown in Table 6.3. The government's annual financial report, containing the final figures for 2013, is to be published soon, ready for Accountability Day on 21 May.

Table 6.3: Guarantees provided by the central government

in billions of euros	2008	2009	2010	2011	2012	2013	2014
Total guarantees	63.5	152.7	152.2	238.2	258.0	217.5	218.5
of which:							
European Financial Stability Facility (EFSF)	-	-	25.9	97.8	97.8	49.6	49.6
DNB participation in IMF capital	9.9	23.4	28.8	47.3	46.5	46.5	46.5
European Stability Mechanism (ESM)	-	-	-	-	35.4	35.4	35.4
Interbank loans guarantee	2.7	47.1	39.0	33.2	17.2	14.1	14.1
European Investment Bank (EIB)	7	9.9	9.9	9.9	9.9	9.9	9.9
De Nederlandsche Bank guarantee	-	-	-	-	-	5.7	5.7
SNS Reaal guarantee	-	-	-	-	-	5.0	5.0

In the light of the increased guarantees, the Risk Arrangements Commission (Commissie Risicoregelingen, CRR) made some recommendations to make the government's risk policy more stringent. As a result of these recommendations and the advice given by the Court of Audit (Algemene Rekenkamer), the government developed a guarantee framework in order to manage risks more effectively. More details can be found in Chapter 7.

Chapter 7: Quality of public finances

The Dutch government promotes quality and sustainability of public finances through legislation, regulations, rules and (fiscal) policy. Another contributing factor is the interplay of 'checks and balances' between organisations such as the Netherlands Bureau for Economic Policy Analysis (Centraal Planbureau), the Council of State (Raad van State) and the Court of Audit (Algemene Rekenkamer). In addition to the existing quality requirements for public finances, the Dutch government recently tightened and improved risk management relating to contingent liabilities, derivatives and Treasury banking. The critical assessment of contingent liabilities, the maintaining of excess funds by local government bodies with the state and the tightening of the derivatives policy all limit the risks for public finances and therefore contribute to a more sustainable development of public finances.

Introduction

The State safeguards the quality of public finances for both the expenditures and revenue. On the expenditure and revenue side, quality is secured by periodically evaluating efficiency and effectiveness of the policy. In addition, annual interdepartmental policy reviews are carried out. During these reviews an area of policy is thoroughly investigated and alternative policy options are presented with a view to making savings or spending more efficiently[11].

Building on the Stability Programme 2013, this chapter focuses on another quality aspect of public finances, namely risk management. The risks for public finances have increased substantially in recent years as a consequence of the financial crisis. The State has taken measures in the form of guarantees, indirect guarantees and loans, for example. As a result, the State's outstanding guarantees rose from 63.5 billion euros in 2008 to 258.0 billion euros in 2012, and then dropped again to 218.5 billion euros in 2014. The risk that the State runs via indirect guarantees has also increased significantly, with the total value of indirect guarantees increasing from 177.7 billion in 2008 to 250.4 billion in 2012. In addition to contingent liabilities, public finances face risks because of the use of derivatives by semi-public bodies and through the risks that local government bodies are exposed to on their excess funds.

This chapter describes the more stringent policy with regard to contingent liabilities, the use of derivatives with public funds and the Treasury banking obligation of local government bodies. It ends with an assessment of the recommendations of the Van Dijkhuizen Commission for revising the tax system.

Risk arrangements

The Dutch government opts to limit explicit risks where necessary or to reduce them to an efficient level. In addition, the Dutch government chooses to reduce implicit (financial) risks by identifying them and including them in the standard (financial) decision making process within the frameworks of the fiscal policy.

The policy for contingent liabilities is laid down in the fiscal rules and in the new framework for guarantees. Based on the fiscal rules, a 'no unless' policy applies with regard to contingent liabilities. Although new arrangements are sometimes necessary, the Dutch government acts in the most reserved manner possible. The government thinks it is important not only to assess new arrangements, but also to use restraint with regard to (amendments to) existing arrangements. Policy initiatives to start a new guarantee will be assessed via the Assessment Framework Contingent Liabilities [12]. The three key elements of the assessment framework are:

[11] The 2013 Stability Programme contains a more detailed clarification of how quality is guaranteed via policy evaluations.
[12] http://www.rijksoverheid.nl/documenten-en-publicaties/regelingen/2012/03/05/toetsingskader-risicoregelingen.html

- Reason for government intervention and choice of instrument, in other words usefulness and necessity;
- Management of risks, both ex ante and ex post (governance);
- Pricing the risk and associated costs (a risk premium).

Additional to the fiscal rules, the framework for guarantees lays down a set of concrete requirements applicable to new and existing risk arrangements.

The *guarantee framework* can be summarised as follows[13]:

- A 'no unless' policy applies to all guarantees and loans.
- In principle all arrangements will have a sunset clause.
- The assessment framework for contingent liabilities is always submitted to Parliament.
- In the case of new arrangements and amendments to existing arrangements, (other) contingent liabilities will have to be decreased.
- A rule will ensure the scaling down of unused ceilings.
- Retrenchment of contingent liabilities is being considered.
- A *second opinion* will be requested from an independent, specialist party with regard to risk management and the setting of premiums for large and complex risks.

Derivatives

The Dutch government is restraining speculation with public funds. Derivatives – financial products with a value derived from underlying products or indices – are not a problem in themselves, given that they can contribute to the management of risks and, at relatively low costs, can provide security with regard to future interest obligations. However, financial innovation has also resulted in products of a speculative nature, offering the chance of large gains and large losses. Speculating with tax or premium revenues is not the task of public and semi-public bodies.

Derivatives policy framework
The government has decided only to permit derivatives in the (semi-)public domain if they provide protection against upward interest risks (*payer swaps* and *interest caps*). *Receiver swaps*, *forward starting swaps* and *interest swaptions* may only be used under strict conditions. The advantage of this limitative list is that the market cannot bypass the public speculation ban on new products. The government has also imposed stricter demands on financial management, control, accountability and supervision of organisations with derivatives on their balance sheets. Line ministers are responsible for a sector-specific interpretation of the ban on speculation. The general framework contains a number of provisions from which the line minister can deviate if there are sound reasons for doing so. After all, sector-specific circumstances may give cause to deviate from the general, overarching framework. That makes customisation possible and ensures that rules are not necessarily restrictive. As regards all other provisions, the sectoral interpretation may be stricter, but not more permissive than the general policy.

The *derivatives policy framework* can be summarised as follows[14]:

- Financial derivatives are only permitted in order to limit upward interest risks.
- Derivatives are not larger than the covered loan and do not run for longer than the covered loan (with a maximum term of 10 years).
- Derivatives are acquired in euros from financial institutions with a single-A rating or higher.
- A bilateral collateral obligation is permitted, as is a unilateral collateral obligation from the financial institution. Collateral obligations necessitate sufficiently large buffers.
- The financial institution may not have a unilateral termination option.
- Institutions that use financial derivatives have an adequately structured internal organisation.

[13] For a full overview see: http://www.rijksoverheid.nl/documenten-en-publicaties/kamerstukken/2013/09/17/rapport-commissie-risicoregelingen-en-kabinetsreactie.html
[14] For the full derivatives policy framework see: http://www.rijksoverheid.nl/documenten-en-publicaties/publicaties/2013/09/17/beleidskader-derivaten.html

- Institutions are accountable with regard to derivatives in a transparent, complete and clear manner in their annual reports. The accountant checks the external accounting.
- Line ministers explicitly appoint a sectoral supervisor.
- Derivatives that are not in line with the framework are scaled down, unless this would result in major losses.

Treasury banking

Since the end of 2013, local governments are required to maintain their excess funds[15] with the Treasury. This obligation reduces government debt as a whole because it is defined as the government's debt to third parties. The obligation also reduces the risks of local governments in relation to their excess funds. Experience has shown that local governments with excess funds, like other economic actors, try to optimise the yield. However, a higher yield also means greater risks. The case of the Icelandic bank Icesave underlined the correlation between high yield and substantial risk for governments. Making it obligatory to put aside excess funds with the State limits the credit risk for local governments. In that way, it also contributes to risk management within the public sector.

Treasury banking means local governments receive interest equal to the interest paid by the Dutch State on financial markets. In return for this yield on excess funds, presumably lower yields than local governments were used to, the corresponding risks lower governments face are also lower. What is more, it is not necessary for every municipal authority to maintain a treasury department to control the risks on outstanding funds. This approach allows Treasury banking to also contribute to efficient spending of public funds. If they wish, local governments can lend out excess funds to each other, on condition that relationships of mutual supervision between the lending and borrowing government bodies do not exist. A provincial authority may not, therefore, loan out funds to a municipal authority inside its own provincial borders. This gives local governments the option of achieving a slightly higher yield while still keeping the risk manageable.

Developments on the revenue side

The Commission on Income Tax and Allowances (Commissie inkomstenbelasting en toeslagen) (Van Dijkhuizen Commission) has made a number of proposals for revising the tax system as regards income tax, allowances and a shift from wage/income tax to indirect taxes. The Commission published its interim report at the end of 2012 and the final report was published in June 2013[16]. These reports contain proposals for creating a simple, solid and fraud-proof tax system. For example, the Commission proposes a rate structure with two tax brackets and fewer allowable deductions and allowances. The government will issue a response to these recommendations during the first six months of 2014.

[15] Defined as all funds that local government bodies do not directly need for the execution of their public tasks.
[16] http://www.rijksoverheid.nl/documenten-en-publicaties/rapporten/2013/06/18/eindrapport-commissie-inkomstenbelasting.html

Chapter 8: Institutional features of public finances

The Law on the Sustainability of Public Finances (Wet Houdbare Overheidsfinanciën, Wet Hof) came into effect on 15 December 2013. This Law codifies the European fiscal agreements regarding the budget balance and gross government debt and the core of the trend-based fiscal policy in national legislation. The most noticeable European fiscal agreement is that, in the medium term, countries will have to balance their budgets in structural terms.

Introduction

This chapter provides an overview of the most important institutional innovations relating to public finances, in this case the entry into force of the Law on the Sustainability of Public Finances. It also assesses the contents of the Law and its effect in practice.

The Law on the Sustainability of Public Finances (Wet HOF)

The essence of the Law is to codify European fiscal agreements and the stipulation that the State and the local governments (municipalities, provincial authorities and regional water authorities) must make an equivalent effort to comply with these agreements. The Law also entrenches the principles of trend-based fiscal policy for the State in national law.

The national codifying of the European fiscal agreements is laid down in Article 2, paragraph 3 of the Law on the Sustainability of Public Finances, which states that the trend-based fiscal policy will exist within the boundaries of the European fiscal agreements. This refers to the requirements in both the corrective arm and the preventive arm of the SGP. The chosen formulation in the Law on the Sustainability of Public Finances, a reference to the European requirements without any additional quantification, means that any future amendments to the SGP, for example the measures to tighten the SGP as implemented in 2011, do not require a change in the law. Also, the medium-term objective (MTO) is recalculated periodically. In the event of literal standardisation in the text of the law, recalculation would require a change in the law. In this way the European requirements are codified in national legislation for the long term.

Besides the European agreements, the principal elements of the Dutch trend-based fiscal policy are laid down in the Law on the Sustainability of Public Finances in accordance with a request by the Lower House to anchor the Dutch fiscal rules in law[17]. The three principal points for fiscal policy are included in the law (see also Article 2, paragraph 2):

1. The use of fixed expenditure frameworks;
2. The principle of automatic stabilisation on the revenue side of the budget;
3. Fiscal policy based on the long-term figures and the macro-economic estimates of the relevant variables by the CPB.

Trend-based fiscal policy combines budgetary discipline with stabilisation of the economy. As already mentioned, trend-based fiscal policy fits within the boundaries of the European fiscal agreements. The stabilising effect of the trend-based fiscal policy is framed by the European fiscal rules because these rules limit the effect of the automatic stabilisers. The disciplining effect of trend-based fiscal policy is strengthened as a result. The Law obliges the Netherlands to take sufficient measures if, based on the economic estimates by the CPB, it is expected that the national and/or European fiscal rules are not respected. The same applies if the European Commission or Council decides that the budget of the Netherlands does not comply with European fiscal rules. The Law also contains a correction mechanism which comes into effect in the event of significant deviations from the MTO or the adjustment path to the MTO as prescribed by the European Commission.

The Law is fully in line with European definitions regarding the circumstances to trigger the correction mechanism and regarding the circumstances for triggering, extending and exiting escape

[17] Parliamentary Documents II, 2010/11, 32,565, no. 4

clauses. A recovery plan based on the MTO that is created as part of the entry into force of the correction mechanism, is included in a budgetary memorandum to be presented to the States-General. If a recovery plan is in effect, the progress being made regarding its execution will be reported in any event annually in the Budget Memorandum. Independent advice is ensured by involving the Council of State as an independent budgetary authority in an advisory role in relation to the recovery plan, both during the presentation of the plan to the States-General and during the monitoring of its execution - in any event annually via the Budget Memorandum. This fulfils principle 7 from the European Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

The fact that the European fiscal agreements monitor the income and expenditure of the entire public sector, including municipalities, provincial authorities and regional water authorities, means that the Law provides a procedure aimed at having local governments make an equivalent effort to the national government as regards achieving and maintaining the European fiscal agreements. The Law provides for formal consultation with the local government bodies before their equivalent effort is determined. In anticipation of the entry into force of the Law on the Sustainability of Public Finances, an agreement was reached in January 2013 with the local government authorities regarding their contribution to the European fiscal agreements during this term of government. The financial agreement contains an ambition and a standard for the multi-annual budget balance path of local governments. The agreed ambition corresponds to the forecast by the CPB for the balance of the local governments, after taking into account the effects of the Coalition Agreement in the period 2014-2017. The agreed upon standard for the budget balance of local governments offers some margin with respect to the ambition. In the event of a deviation from the ambition it is, therefore, not immediately necessary for local governments to take further measures.

Table 8.1: Standardisation of EMU balance for local governments

as percentage of GDP	2013	2014	2015	2016	2017
Ambition for shared EMU balance of joint local governments	-0.5	-0.3	-0.3	-0.2	-0.2
The agreed deficit standard for this term of government, in accordance with the HOF Law[18]	-0.5	-0.5	-0.5	(-0.4)	(-0.3)

In 2013 a deficit standard of 0.5 percent GDP applied to all local government bodies jointly. The realised balance of the local government bodies was -0.3 percent of GDP in 2013. This means an overachievement of the agreed deficit standard.

[18] At the end of 2015 official consultations will take place to assess whether, on the basis of the realisations available at that time, the projected reduction is justifiable and possible in 2016 and 2017.

ANNEX 1: Tables relating to the reporting obligation within the framework of the excessive deficit procedure

Table 1a: Budgetary prospects on a quarterly basis and cash basis for the entire government and other governing bodies

in millions of euros	**2014***			
	Q1	Q2	Q3	Q4
Net financing balance per public government sector				
1. General government	-4,471	-4,471	-4,471	-4,471
2. Central government	-2,645	-2,645	-2,645	-2,645
3. State government	-2,633	-2,633	-2,633	-2,633
4. Local government	-579	-579	-579	-579
5. Social security funds	-1,247	-1,247	-1,247	-1,247
6. Total revenue	72,876	72,876	72,876	72,876
of which:				
central government:	43,118	43,118	43,118	43,118
state government:	42,919	42,919	42,919	42,919
local government	9,434	9,434	9,434	9,434
social security funds:	20,324	20,324	20,324	20,324
of which:				
direct taxes	17,576	17,576	17,576	17,576
indirect taxes, of which:				
VAT	18,464	18,464	18,464	18,464
social security contributions	26,281	26,281	26,281	26,281
other	10,061	10,061	10,061	10,061
income from capital	49	49	49	49
7. Total expenditure				
of which:				
intermediate consumption	10,766	10,766	10,766	10,766
compensation of employees	14,575	14,575	14,575	14,575
interest payments	2,762	2,762	2,762	2,762
subsidies	1,930	1,930	1,930	1,930
social security benefits	38,239	38,239	38,239	38,239
other	354	354	354	354
capital transfers	493	493	493	493
gross investment in fixed assets	5,091	5,091	5,091	5,091

*The figures provided are largely based on the 2014 Central Economic Plan (CPB). These figures are only available on an annual basis. Breakdown into quarterly figures is the result of straight-line interpolation.

Table 1b: Budgetary prospects for the entire government and other governments based on ESA standards and not-adjusted for seasonal effects

in millions of euros	ESA code	2014			
		Q1	Q2	Q3	Q4
Net financing balance					
1. General government	S.13	-4,471	-4,471	-4,471	-4,471
2. Central government	S.1311	-2,645	-2,645	-2,645	-2,645
3. State government	S.1312	-2,633	-2,633	-2,633	-2,633
4. Local government	S.1313	-579	-579	-579	-579
5. Social security funds	S.1314	-1,247	-1,247	-1,247	-1,247
6. Total revenue	TR	72,876	72,876	72,876	72,876
of which:					
taxes on production and import levies	D.2	18,464	18,464	18,464	18,464
taxes on income, assets, etc.	D.5	17,576	17,576	17,576	17,576
capital levies	D.91	49	49	49	49
social security contributions	D.61	26,281	26,281	26,281	26,281
income from assets	D.4	397	397	397	397
other		10,061	10,061	10,061	10,061
7. Total expenditure	TE	77,374	77,374	77,374	77,374
of which:					
compensation of employees	D.1	14,575	14,575	14,575	14,575
intermediate consumption	P.2	10,766	10,766	10,766	10,766
social security benefits	D.62, D.632c	38,239	38,239	38,239	38,239
interest charges	D.41	2,762	2,762	2,762	2,762
subsidies	D.3	1,930	1,930	1,930	1,930
gross investment in fixed assets	P.51	5,091	5,091	5,091	5,091
capital transfers	D.9	493	493	493	493
other		354	354	354	354
8. Gross debt	D.1	114,834	114,834	114,834	114,834

*The figures provided are largely based on the 2014 Central Economic Plan (CPB). These figures are only available on an annual basis. Breakdown into quarterly figures is the result of straight-line interpolation.

Table 1c: Annual budgetary objectives in accordance with ESA standards for the entire government and other governments

as percentage of GDP	ESA Code	2013	2014	2015
Net financing balance per government sector				
1. General government	S.13	-2.5*	-2.9	-2.1
2. Central government	S.1311	-0.9	-1.7	-2.6
3. State government	S.1312	-0.9	-1.7	-2.6
4. Local government	S.1313	-0.3	-0.4	-0.3
5. Social security funds	S.1314	-1.3	-0.8	0.8
6. Total revenue	TR	47.3	47.4	47.7
7. Total expenditure	TE	49.8	50.3	50.0
8. Interest charges	D.41	1.8	1.8	1.8
9. Primary balance		-0.7	-1.1	-0.4
10. One-off and other temporary measures		0.6	0.0	0.0
		change	change	change
11. Actual GDP growth		-0.8	¾	1¼
12. Potential GDP growth		0.3	¼	¼
of which:				
- labour		0.0	-¼	-¼
- capital		0.2	¼	¼
- total factor productivity		0.1	¼	¼
		% pot. GDP	% pot. GDP	% pot. GDP
13. Output gap		-3.6	-3	-2¼
14. Cyclical budgetary component		-2.1	-1.7	-1.3
15. Cyclically adjusted balance (1 - 14)		-0.5	-1.2	-0.8
14. Cyclically adjusted primary balance (13 + 6)		1.3	-0.9	-0.5
15. Structural balance (13 - 10)		-1.1	-1.2	-0.8

* This number does not take any account of effects on the government balance sheet of the nationalisation of the SNS Bank. As a result, based upon currently available information, there is an upward risk of at most 0.3 percentage points.

Table 2: Objectives for income and expenditure of the entire government in accordance with ESA standards

as percentage of GDP	ESA Code	2013	2014	2015
1. Total revenue target	TR	47.3	47.4	47.7
of which:				
1.1. Taxes on production and import levies	D.5	11.7	12	11.8
1.2. Taxes on income, assets, etc.	D.91	10.9	11.4	11.9
1.3. Capital levies	D.61	0.3	0.3	0.3
1.4. Social security charges	D.4	16.9	17.1	17.3
1.5. Income from assets		3.2	2.6	2.5
1.6. Other		4.1	4.0	3.9
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		39.6	40.7	41.3
2. Total expenditure target	TE	49.8	50.3	50.0
of which:				
2.1. Compensation of employees	D.1	9.7	9.5	9.4
2.2. Intermediate consumption	P.2	7.4	7.0	7.0
2.3. Social security benefits	D.62, D.6311, D.63121, D.63131f	24.6	24.9	25.2
of which:				
Unemployment benefits	D.41			
2.4. Interest payments	D.3	1.8	1.8	1.8
2.5. Subsidies	P.51	1.3	1.3	1.2
2.6. Gross investments in fixed assets	D.9	3.2	3.3	3.2
2.7. Capital transfers	D.41	0.3	0.3	0.3
2.8. Other	D.3	1.5	2.3	2.1