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Recommendation for a

COUNCIL RECOMMENDATION

with a view to bringing an end to the situation of an excessive government deficit in the Netherlands

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 126(7) thereof,

Having regard to the recommendation from the European Commission,

Whereas:

(1) According to Article 126 of the Treaty on the Functioning of the European Union (TFEU) Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) On 2 December 2009, the Council decided, in accordance with Article 126(6) TFEU, that an excessive deficit existed in the Netherlands and issued a recommendation to correct the excessive deficit by 2013 at the latest[1], in accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[2]. In order to bring the general government deficit below 3% of GDP in a credible and sustainable manner, the Dutch authorities were recommended to implement the fiscal measures in 2010 as envisaged in the 2010 budget and, starting consolidation in 2011, put an end to the excessive deficit situation by 2013. To this end, they were recommmended to ensure an average annual fiscal effort of ¾% of GDP over the period 2011-2013, specify the measures that were necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting and accelerate the reduction of the deficit if economic or budgetary conditions were to turn out better than expected at that time. The Council established a deadline of 2 June 2010 for effective action to be taken.

(4) On 15 June 2010, the Commission concluded that based on the Commission services' 2010 Spring Forecast, the Netherlands had taken effective action in compliance with the Council recommendation of 2 December 2009 to bring its government deficit below the 3% of GDP reference value and considered that no additional step in the excessive deficit procedure was therefore necessary at that point in time.

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[1] All documents related to the excessive deficit procedure of The Netherlands can be found at:http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/netherlands_en.htm

[2] OJ L 209, 2.8.1997, p. 6

(5) According to Article 3(5) of Regulation (EC) No 1467/97, the Council may decide, on a recommendation from the Commission, to adopt a revised recommendation under Article 126(7) of the TFEU, if effective action has been taken and unexpected adverse economic events with major unfavourable consequences for government finances occur after the adoption of that recommendation. The occurrence of unexpected adverse economic events with major unfavourable budgetary effects shall be assessed against the economic forecast underlying the Council recommendation.

(6) In accordance with Article 126(7) TFEU and Article 3 of Council Regulation (EC) No 1467/97, the Council is required to make recommendations to the Member State concerned with a view to bringing the situation of an excessive deficit to an end within a given period. The recommendation has to establish a maximum deadline of six months for effective action to be taken by the Member State concerned to correct the excessive deficit. Furthermore, in a recommendation to correct an excessive deficit the Council should request the achievement of annual budgetary targets which, on the basis of the forecast underpinning the recommendation, are consistent with a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0.5% of GDP as a benchmark.

(7) The Commission services' 2009 Autumn Forecast, which was underlying the Council recommendation under Article 126(7) TFEU of 2 December 2009, projected that the Dutch economy would contract by 4.5 % in 2009, followed by a modest recovery in 2010 and 2011, with GDP growth of ¼% and 1½ % respectively. The years 2012 and 2013 were beyond that forecast's horizon, but under the hypothesis of a gradual closure of the large negative output gap by 2015, higher growth than in 2011 was expected for 2012 and 2013. GDP growth in 2009 fell by 3.7%, less than expected in the Commission services' 2009 Autumn Forecast, and in 2010 the export-led recovery at 1.6% was stronger, but in 2011 economic growth slowed to 1% and in 2012 the Dutch economy slipped back into recession. In 2011, the Netherlands already recorded negative quarterly growth rates in all except the first quarter and in 2012, the Dutch economy contracted by 1%. The quarter-on-quarter growth was slightly positive in the first half of the year, but plummeted thereafter. Overall, GDP growth turned out to be markedly lower than could have been expected under a pattern of normal cyclical recovery and the sizeable contraction of the economy has affected employment negatively; unemployment has risen, real wage growth turned negative and domestic demand declined.

(8) The Commission services' 2013 Spring Forecast projects real GDP to continue to drop by 0.8% in 2013, although growth is expected to return gradually to positive territory from the second half of the year onwards. Trade developments are expected to contribute to the recovery, whereas domestic demand is forecast to remain depressed well into 2013. Uncertainty regarding the general economic outlook, implementation of reform proposals and possible additional consolidation measures put an additional drag on domestic demand. In 2014, both exports and imports are expected to gain momentum and domestic demand should begin to pick up gradually, supporting a fragile recovery, with real GDP increasing by 0.9%.

(9) The Netherlands had chosen to delay fiscal adjustment until 2011. This approach was endorsed in the 2009 Council recommendation which specifically recommended that the 2010 budget be implemented while consolidation should start only in 2011. In response, the Netherlands designed a multi-annual package of mainly expenditure-

based measures over the period 2011-2015. Implementation of the measures up to 2013 is by and large on track. After some over-performance of real GDP in 2009 and 2010 compared to the 2009 Commission services' 2009 Autumn forecast underlying the EDP recommendation, economic performance in the Netherlands deteriorated significantly from 2011 onwards. This translated into a similar development in public finances, with some initial over-performance to the budgetary targets until and including 2011. In 2011, the general government deficit reached 4.5% of GDP and subsequently, improved to -4.1% of GDP in 2012.Turning to the driving forces of the deficit, swings in economic growth have mainly affected government revenues. The initial recovery from the financial crisis, with stronger-than-expected economic activity in 2010 and the first part of 2011, at first led to a fairly strong revenue performance. However, subsequently revenue fell short of what was expected, particularly in the second half of 2011 and in 2012, in the wake of faltering growth. This adverse pattern is expected to continue, largely driving the weak deficit outlook. Overall trends mirror the cyclical sensitivity of revenue which the Netherlands typically exhibits.

(10) According to the Commission services' 2013 Spring Forecast, the general government deficit is expected to improve further to 3.6% of GDP in 2013, due to sizeable consolidation measures mainly on the revenue side, notably the increase in the VAT rate and increases in excises, while on the expenditure side a wage freeze for civil servants and the non-indexation of income tax brackets will contribute to consolidation. Furthermore, in 2013 significant one-off operations will impact on the deficit[3]. The sale of 4G mobile telephony licenses and the nationalisation of SNS Reaal (both impacting on 2013) broadly cancel out. On balance, however, one-offs have a decreasing impact on the deficit of around 0.2% of GDP, in particular related to dividend payments from the De Nederlandsche Bank and the restitution by Havenbedrijf Rotterdam of state contributions to port enlargement. Specified and agreed measures that are embedded in the multi-annual fiscal projections entail on-going savings in 2014. In addition, positive one-offs emanating from dividend streams from the De Nederlandsche Bank and a crisis levy on banks will have a downward effect on the headline deficit. Nonetheless, since revenue is expected to remain subdued in view of the sluggish recovery, the general government deficit is projected to stabilise at 3.6% of GDP in 2014. The Commission services' 2013 Spring Forecast does not incorporate the additional consolidation package for 2014 proposed by the government in March 2013 but then withdrawn temporarily in response to the agreement reached with social partners in April 2013.

(11) Non-negligible implementation risks are attached to the fiscal outlook for 2014 and beyond. As regards measures embedded in the coalition agreement, these risks originate mainly from the foreseen efficiency gains planned to be achieved by decentralising tasks to municipalities. In the Netherlands, coalition agreements traditionally were implemented largely unchanged. Recently, there have been several examples of substantive changes, responding e.g. to the reappraisal of original plans by the coalition partners or the agreement with the social partners. In any case, the headline deficit forecast for 2014 suggests that substantial additional measures are called for in order to bring the headline deficit below 3% of GDP in 2014.

[3] This interpretation on the classification of these operations does not prejudge Eurostat's formal assessment.

(12) According to the Commission services' updated 2013 Spring Forecast, the structural balance is expected to improve by around 0.7 % of GDP per year on average over the adjustment period 2010-2013 but is forecast to deteriorate in 2014 by around 0.3 pp. On the basis of the SF2013, the average fiscal effort over the period 2011-2013 would thus be close to the required ¾% of GDP. When adjusted for the significant downward revision in potential output growth since the time when the 2009 EDP recommendation was issued and for the impact of revisions on the composition of economic growth on revenue, the average annual structural effort (1.1% of GDP) exceeds the recommended average annual fiscal effort (¾% of GDP) over 2011-2013 required in the 2009 Council EDP recommendation by a substantial margin. The Netherlands can therefore be considered to have taken effective action in line with the Council Recommendation. For the period 2011-2013 the overall fiscal effort according to a bottom-up approach amounts to 4% of GDP, or around 1.3 % of GDP annually, broadly equally divided between revenue and expenditure measures. The bottom-up assessment of the fiscal consolidation measures taken in the years 2010-2013 thus confirms the conclusion that effective action has been taken by the Netherlands.

(13) Debt dynamics in the Netherlands have been unfavourable. In 2008, significant government operations to support Dutch banks had been a major factor pushing up the government debt ratio, increasing it to to 58.5% coming from 45.3% of GDP in 2007. In the period 2008-2012 it steadily increased to 71.2% in 2012. On the basis of the Commission services' 2013 Spring forecast the debt ratio is expected to further increase to 74.6% of GDP in 2013 and 75.8% of GDP in 2014. This is predominantly the result of the persistent headline deficits in combination with low nominal GDP growth, whilst EFSF and ESM operations attributed to the government debt only have a relatively small upward effect. The uptick in the expected gross debt ratio for 2013 includes debt-increasing operations equivalent to some 1% of GDP related to the nationalisation of SNS Reaal in early 2013 (on top of the deficit-enhancing measures amounting to around 0.6% of GDP).

(14) Consistent with the rules of the Stability and Growth Pact, considering all these factors , in particular the substantial deterioration in the budgetary position resulting from the weaker overall position of the economy relative to the one underlying the original Council recommendation under Article 126(7) TFEU, suggests that a new deadline for the correction of the excessive deficit in the Netherlands by 2014 is appropriate.

(15) Against the background of high uncertainties regarding economic and budgetary developments, the budgetary target recommended for the final year of the correction period should be set at a level clearly below the reference value, in order to guarantee an effective and lasting achievement of the correction within the requested deadline.

(16) Granting an additional year for the correction of the excessive deficit would be commensurate with intermediate headline deficit targets of 3.6% of GDP for 2013 and 2.8% of GDP for 2014. The underlying improvement in the structural budget balance implied by these targets is 0.6% of GDP in 2013, and 0.7% of GDP in 2014. In total, to reach the above-mentioned structural targets, the Dutch authorities would need to ensure the delivery of the foreseen structural effort in 2013 and adopt additional consolidation measures of at least 1% of GDP in 2014, on top of the measures already included in the baseline scenario. These targets take into account the need to

compensate for the negative second-round effects of fiscal consolidation on public finances, through its impact on GDP growth.

(17) The European Commission Fiscal Sustainability Report 2012 shows that the Netherlands does not face a risk of fiscal stress in the short run. The country is at medium sustainability risk in the medium to long run. Although the 2013 pension reform is an important positive step, additional measures, in particular related to curbing long-term care expenditure, are necessary to fully ensure the long-term sustainability of public finances.

(18) The Netherlands fulfils the conditions for the extension of the deadline for correcting the excessive general government deficit as laid out in Article 3(5) of Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure,

HAS ADOPTED THIS RECOMMENDATION:

(1) The Netherlands should put an end to the present excessive deficit situation by 2014 at the latest.

(2) The Netherlands should reach a headline deficit target of 3.6% in 2013 and 2.8% of GDP in 2014, which is consistent with an improvement of the structural balance of around 0.6% and 0.7% of GDP respectively, based on the Commission services' updated 2013 Spring Forecast.

(3) The Netherlands should implement the multiannual measures already adopted with the 2013 budget, while standing ready to compensate them if their yield would prove less than currently foreseen, and implement additional measures sufficient to achieve a correction of the excessive deficit in 2014. The Council establishes the deadline of [1 October] for the Netherlands to take effective action and, in accordance with Article 3(4a) of Council Regulation (EC) No 1467/97, to report in detail the consolidation strategy that is envisaged to achieve the targets.

In addition, to ensure the success of the fiscal consolidation strategy, it will be important to back the fiscal consolidation by comprehensive structural reforms, in line with the Council recommendations addressed to the Netherlands in the context of the European Semester and in particular those related to the preventive arm of the Macroeconomic Imbalances Procedure.

This recommendation is addressed to the Kingdom of the Netherlands.

Done at Brussels,

For the Council
The President