Raad van State

No. W06.23.00226/III 's-Gravenhage, 13 September 2023

In the Government Missive of 4 September 2023, No. 2023001840, Your Majesty, on the recommendation of the Minister of Finance, submitted the draft 2024 Budget Memorandum and 2023 September Report on Fiscal Monitoring to the Advisory Division of the Council of State for consideration, with an explanatory memorandum.

A. INTRODUCTION AND CONCLUSION

1. Introduction

In this report the Advisory Division of the Council of State publishes its opinion on the 2024 Budget Memorandum and the report related to independent fiscal monitoring.

The Advisory Division of the Council of State has been charged with the independent budgetary monitoring of compliance with (European) fiscal rules as referred to in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG) and Article 5 of Regulation (EU) 473/2013 and as included in Article 2 (8) of the Sustainable Public Finances Act. It is the task of the independent budgetary monitoring institute to draw up an assessment of whether European fiscal rules are being met. The demissionary government's response to the September Report on fiscal monitoring is included in full in this report.

The opinion on the Budget Memorandum stems from the Sustainable Public Finances Act (Wet Houdbare Overheidsfinanciën, 'Wet HOF'). The government responds to the opinion on the Budget Memorandum in a further report sent to the House of Representatives at the same time as the opinion on the Budget Memorandum.

In its assessment the Advisory Division works closely with the CPB Netherlands Bureau for Economic Policy Analysis. The division of tasks entails that the drawing up of independent macroeconomic and budgetary forecasts and analyses are assigned to the CPB. The Advisory Division has been charged with the more normative assessment of compliance with both European and national fiscal rules.

In the interests of quality and meticulousness in drawing up the assessment, for the September Report and the opinion on the Budget Memorandum, the Advisory Division was able to consult a draft version of the 2024 Budget Memorandum.

This report is structured as follows:
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TO THE KING

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2. <u>Summary conclusion and advice</u>

The demissionary government presents its final Budget Memorandum of this government term on Budget Day. Thus, the budget documents are relatively limited in policy terms. After the upcoming elections to the House of Representatives, a new government will formulate the fiscal policy to be pursued and the fiscal rules for the upcoming government term. Developments pertaining to the economy and public finances in the medium and long term, as well as the fiscal position are relevant in this process.

Forward-looking fiscal policy
Create forward-looking fiscal policy. That is the essence of the Advisory Division's opinion on this Budget Memorandum and the corresponding budget in view of the upcoming government period. This opinion consists of three interrelated parts. Firstly, use the first Budget Memorandum of the upcoming government term for an Initial Policy Memorandum on Broad Prosperity, containing an analysis of the future Dutch economic, social, ecological and financial structure, linked to the objectives of the upcoming coalition agreement. Secondly, gradually make fiscal policy and the budget system climate-inclusive and incorporate climate in the analyses of the sustainability of public finances. Thirdly, implement shock-resistant fiscal policy with sufficient fiscal scope at the outset to avoid budget cuts later on. It will create more certainty in the implementation of public policies, which serves a social interest.

Initial Policy Memorandum on Broad Prosperity and structural analysis
In the 2024 Budget Memorandum, the government has given broad prosperity a prominent position in relation to macroeconomics and public finances, affording the concept of broad prosperity greater significance. Consequently, the

government is heeding the Advisory Division's advice regarding the 2023 Budget Memorandum to analyse the socio-economic structure of the Netherlands. The Advisory Division sees this analysis as a good first step, which needs more coherence and further broadening, deepening and elaboration for the next government. It is important that long-term policies that are effective, stable, predictable and feasible are implemented. The Advisory Division recommends the next government’s first Budget Memorandum be used for an analytical deepening of the new coalition agreement, in order to develop an ‘Initial Policy Memorandum (in terms of) Broad Prosperity’. Subsequent Budget Memoranda can then be used to monitor and possibly adjust political priorities, without compromising on the long-term focus.

Climate-inclusive budgetary framework
Climate change constitutes one of the biggest societal challenges for the coming decades, alongside the issue of an ageing population, and will also lead to structural changes in public finances. Therefore, the Advisory Division deems it necessary to create a climate-inclusive budgetary framework, which incorporates climate adaptation and climate mitigation.

The development of a climate-inclusive budgetary framework is a growth model, to be achieved gradually; not everything can and needs to be done at once. But it is imperative that we start now. Elements of a climate-inclusive budgetary framework, under the joint responsibility of the ministers of Finance and Climate & Energy, are:

- Greater understanding of the (future) fiscal implications of climate change.
- Broad definitions and classification of climate-related expenditure and revenue consistent with European methods.
- Transparency in the budget, including for the purpose of implementing parliamentary rights associated with the budget; including considering a separate Climate expenditure ceiling.
- Proper budgetary accountability and reporting.

Shock-resistant future fiscal policy
In previous opinions on the Budget Memorandum, the Advisory Division pointed out that unambiguous anchors for fiscal policy serve a democratic interest and reinforce parliamentary rights associated with the budget; it is important for fiscal policy to contribute to citizens' confidence in the effective provision of public services and policy intentions. The Advisory Division considers the following elements most important for future fiscal policy, given the current state of the economy and public finances and given the structural challenges related to the climate and an ageing population:

- Opt for fiscal anchors that provide scope for automatic stabilisers to operate, to avoid interim spending cuts or tax increases, even in the event of budgetary setbacks and economic downturns.
- Make fiscal policy and the budget system climate-inclusive.

- Make broad prosperity more tangible by using the next government's first Budget Memorandum to produce an 'Initial Policy Memorandum on Broad Prosperity' to promote coherent long-term policies.
- When the new government first takes office, have the coalition agreement independently assessed. Create calm in the budgetary process, with fixed times for the Spring Memorandum and Budget Day, aligned to the European Semester. It may become mandatory for Member States to submit multi-year plans to the European Commission as early as next spring.

Budgetary assessment
For 2023 and 2024, the Dutch budget is expected to meet the requirements from the SGP's corrective arm. However, for both years, it does not comply with the rules for the structural balance, which implies that the fiscal policy is expansionary. After 2024, the budget deficit and EMU debt are expected to increase. Consequently, analyses for the medium and long-term sustainability of public finances point to a deterioration in sustainability.

The government did provide the purchasing power package, as presented in the 2024 Budget Memorandum, with structural measures on the expenditure and revenue side of the budget and the outstanding decisions in the revenue framework with structural excess coverage. As with the Spring Memorandum, this is a good step for improving public finances. In 2023, 2025 and 2026, the entire purchasing power package is not covered. However, with full coverage of purchasing power measures on the revenue side, the separation between revenue and expenditure is not respected. The Advisory Division was unable to assess the expenditure ceiling and revenue framework because the CPB did not provide an overview and analysis of all ceiling adjustments and framework corrections with the August decisions due to the government's demissionary status.

The Advisory Division notes that it has not been able to conduct a full budgetary assessment this government term because information was missing or there was no orderly budgetary process. The Advisory Division considers it important for the next government to comply with its own agreed fiscal rules and arrangements, and for independent calculations of policy intentions and an assessment under national and European fiscal rules to be possible. To begin when a new government takes office. This will create calm in the budgetary process, which promotes policy predictability and stable implementation.

B. MACROECONOMIC AND BUDGETARY CONTEXT

1. The Macroeconomic Outlook

Short term (2023-2024)
After strong (catch-up) growth in 2021 and 2022, the Dutch economy shows a deceleration in 2023, according to the CPB in the Macroeconomic Outlook 2024.[1] Because the global economy is growing relatively slowly, the growth of Dutch exports is decreasing compared to recent years, as is the growth of re-exports.[2] This is reflected in a sharp decrease in production at industrial firms since April 2022, for whom high energy prices are also a factor. Rising interest rates are contributing further to a cooling of the economy. Business investment growth weakened partly because of higher interest rates on loans. Due to rising mortgage rates, house prices are falling, resulting in a contraction in investment in housing.

The persistently tight labour market, accelerating wage growth and government support are having a mitigating effect. With the economy cooling, labour market tightness and high inflation are easing somewhat. Growth in employment is declining and is entirely due to government demand for labour. However, unemployment remains low as the number of available jobs remains high. The combination of a tight labour market and high inflation leads to higher wage growth. Increases in the incidental wage, in addition to the collective wage, indicate an improving bargaining position for workers. Higher wages can boost productivity growth, by driving business dynamics.

The draft Macroeconomic Outlook shows that the labour income share, the share of domestic income accruing to employed people, fell in 2022, declined further in 2023 and increases slightly in 2024.[3] This trend and the sharp rise in corporate tax revenues suggest that there is still space in relation to wages at the macroeconomic level. At the same time, there are significant differences between industries. This means wage increases will partly affect core inflation.

In 2024, purchasing power partially recovers from losses in 2022 and 2023 and real wage growth is positive. However, this masks differences between households. Poverty increases substantially in 2024 in the draft Macroeconomic Outlook due to the end of temporary income support policies. The government adopted a purchasing power package to support vulnerable groups based on the

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[1] CPB Netherlands Bureau for Economic Policy Analysis (2023). Macroeconomic Outlook 2024. CPB forecast September 2023.

[2] A recent study by the CPB on the causes of post-Covid-19 economic growth shows that exports of Dutch goods have grown rapidly since the Covid-19 crisis, contributing to strong GDP growth in recent years. Re-exports in particular grew spectacularly, according to the CPB. See CPB Netherlands Bureau for Economic Policy Analysis (2023). Wederuitvoer motor achter stijging Nederlandse export. (Re-exports drive the rise in Dutch exports.) CPB - August 2023.

[3] CPB Netherlands Bureau for Economic Policy Analysis (2023). Draft Macroeconomic Outlook 2024. CPB forecast August 2023.

results of the CPB's draft Macroeconomic Outlook. The purchasing power package stabilises the number of people in poverty in 2024 compared to 2023.

The estimate in the Macroeconomic Outlook, which incorporates the August decision-making based on the draft Macroeconomic Outlook, shows only minor differences compared with the latter. The CPB's forecast is fraught with uncertainty, partly because of major risks abroad, such as the war in Ukraine and other geopolitical tensions, and the fall of the government. What's more, given the sharp rise in interest rates, increasing debt problems in other European governments is a risk too. An upside risk, which may cause the economy to cool less than expected, is the unusually high savings rate: a fall to the long-term average would be a major economic boost.

Table 1: Key figures of macroeconomic developments 2022-2024

	2022	2023		2024	
(changes in % per annum)	**MEV 2024**	*CEP 2023*	**MEV 2024**	*CEP 2023*	**MEV 2024**
Eurozone					
Gross domestic product (economic growth)	3.5	*0.8*	0.5	*1.5*	1.3
The Netherlands					
Gross domestic product (economic growth)	4.3	*1.6*	0.7	*1.4*	1.5
Labour productivity business sector (per hour)	1.0	*0.4*	-0.9	*1.1*	0.8
Gross investments by companies (excl. Housing %)	4.0	*0.0*	8.5	*1.2*	0.5
Investments by companies in housing	1.0	*-1.1*	-0.4	*-1.5*	-6.2
Household consumption	6.6	*1.7*	0.6	*1.4*	2.4
Static purchasing power	-2.7	*-0.2*	-1.1	*2*	1.8
Inflation, national consumer price index	10	*3*	3.9	*3.1*	3.8
Persons in poverty	4.7	*4.7*	4.8	*5.8*	4.8
Imports of goods and services	3.8	*4.2*	1.9	*2.5*	2.1
Exports of goods and services	4.5	*3.7*	0.8	*2.3*	1.5
Collective labour agreement wages companies	3.1	*5*	5.8	*5*	5.6
Employment (in hours)	3.9	*1.2*	1.2	*0.4*	0.6
Unemployed working population (level in %)	3.5	*3.9*	3.6	*4.1*	4

Source: CPB, Macroeconomic Outlook 2024, Central Economic Plan 2023

Medium term (2025-2028)
The CPB also published an outlook for 2025-2028 with regard to macroeconomics and public finances, the Medium Term Outlook (MLT), along with the Draft Macroeconomic Outlook 2024. The MLT serves as the starting point for calculating the election programmes. The August decision-making process is

incorporated in the 2024 Budget Memorandum, departmental budgets and the MEV, but no longer in the MLT.

Economic growth is expected to slow to an average of 1.1% in 2025-2028. This is based on the assumption that economic growth will move towards an equilibrium situation, as business cycles are not easy to predict. The growth in the labour supply is gradually declining, partly due to the ageing population and because participation rates are rising less within cohorts. The slowdown in the growth of structural productivity continues. A shift in the Dutch economic structure towards a service economy plays a role in this regard. The other causes of the (global) slowdown in the growth of productivity are unclear. Given lower growth in the labour supply and growth in employment in the public sector, employment in the market sector will decline in the medium term. Employment in the care sector will grow faster than growth in the labour supply in the period up to 2028, so there will be fewer people available to work in the market sector in the medium term.

Major medium-term economic uncertainties are caused by labour market tightness and international developments and tensions. Ambitious global climate policies will also be needed in the coming years to keep the Paris Agreement targets in sight. The impact of these policies, and climate change itself, on global economic developments is difficult to estimate.

Table 2: Key figures of macroeconomic developments 2025-2028

(changes in % per annum)	2025	2026	2027	2028
Eurozone				
Gross domestic product (economic growth)	1.3	1.2	1.1	1.1
The Netherlands				
Gross domestic product (economic growth)	1.2	1.1	1.1	1.1
Labour productivity business sector (per hour)	1.0	1.0	0.9	0.9
Gross investments by companies (excl. Housing %)	1.0	0.8	0.0	1.8
Investments by companies in housing	1.1	1.1	1.0	1.0
Household consumption	2.0	1.8	1.7	1.8
Static purchasing power	0.7	1.2	0.8	1.1
Inflation, national consumer price index	2.6	2.5	2.4	2.1
Persons in poverty	6.0	5.9	6.0	6.1
Imports of goods and services	3.0	2.8	3.0	3.3
Exports of goods and services	2.3	2.2	2.1	2.1
Collective labour agreement wages companies	4.7	4.5	3.8	3.5
Employment (in hours)	0.0	0.1	0.1	0.2
Unemployed working population (level in %)	4.2	4.4	4.6	4.8

Source: CPB, Draft Macroeconomic Outlook 2024

Even with the slowdown in growth, the economy will perform above the equilibrium level in the coming years, manifested predominantly in a persistently tight labour market and higher inflation. The government is a major contributor to the state of the economy, the tight labour market and inflation by pursuing expansionary fiscal policy and as a result of the high demand for labour in the public sector. The Dutch economy is, as is well known, rather sensitive to European and international developments, but the Advisory Division notes that national political choices may also contribute to the economy cooling in the coming government terms. It is also against this background that the Advisory Division's previous advice to move towards a structural economic analysis must be understood, which is discussed further in Section C of this opinion, as well as the need to set priorities ('not everything is possible and certainly not at the same time'), previously underlined by the Advisory Division.[4]

2. The budgetary outlook

Short term (2023-2024)

There has been an increase in public expenditure since the start of the current government term due to additional intensifications with regard to asylum, defence, education and infrastructure, among others. In 2023 and 2024, the CPB expects government debt to remain below 50% of GDP. Government debt is depressed by high inflation (the denominator effect) and by the assumption that the government will not manage to spend all budgeted funds due to the tight labour market and other implementation issues. The underspend is estimated to be higher in 2024 due to the fall of the government, however, this is subject to considerable uncertainty.

Against the contractive effect of underspending, declining revenues are offset by lower gas revenues in 2024 than in 2023 and declining revenues in wage and income tax. On the contrary, corporate income tax revenues are expected to rise sharply in 2023 compared to 2022. The cost to the government of the one-off solidarity levy on natural gas products ends in 2023, and the cost of the temporary energy measures in 2024. Furthermore, after phasing out previous support measures, tax revenues on energy will increase again in 2023. On balance, falling total revenue and rising expenditure mean that in 2024, the budget deficit rises slightly compared with 2023 to -2.4% of GDP.

[4] Draft Budget Memorandum 2023 opinion and September Report on Budgetary Monitoring, Parliamentary Documents II 2022/23, 36200, No. 6.

Table 3: Key public finance figures 2022-2024

(in % of GDP)	2022 MEV 2024	2023 *CEP 2023*	2023 MEV 2024	2024 *CEP 2023*	2024 MEV 2024
Gross general expenditure	43.7	*45.2*	44.1	*44.4*	44.9
General government revenue	38.6	*38.3*	38.8	*38.1*	38.7
Actual EMU balance	-0.1	*-3*	-1.5	*-2.6*	-2.4
of which EMU balance for local government	0.2	*-0.1*	-0.1	*-0.3*	-0.3
Structural EMU balance	-1.0	*-3.6*	-1.6	*-3*	-2.2
EMU debt	50.1	*48.4*	47.7	*48.7*	46.9

Source: CPB, Macroeconomic Outlook 2024, Central Economic Plan 2023

Medium term (2025-2028)
The estimate in the CPB's draft Macroeconomic Outlook shows that public finances are expected to deteriorate in the medium term. If policies remain unchanged, not including August decision-making for the 2024 budget, government deficit and government debt will increase. In 2026, 2027 and 2028, the budget deficit is expected to exceed the rule for the maximum European budget deficit of 3% of GDP. Since the previous government took office in 2019, public expenditure has continuously increased faster than the economy, partly due to crisis policies following the Covid-19 pandemic and the (consequences of the) war in Ukraine. If policies remain unchanged, this increase will continue in the coming years.

Table 4: Key public finance figures 2025-2028

(in % of GDP)	2025	2026	2027	2028
Gross general expenditure	45.0	46.1	45.9	46.7
General government revenue	38.5	38.9	38.9	39.0
Actual EMU balance	-2.6	-3.4	-3.3	-3.6
of which EMU balance for local government	-0.3	-0.3	-0.3	-0.4
Structural EMU balance	-2.1	-2.9	-2.7	-3.0
Government debt	48.3	50.1	51.8	53.0

Source: CPB Netherlands Bureau for Economic Policy Analysis (2023) Draft Macroeconomic Outlook 2024.

The increase in the budget deficit is partly caused by additional expenditure, such as for climate and nitrogen funds and additional defence spending. Moreover, a decrease in underspending is estimated, due to an expected gradual decrease in staff shortages and bottlenecks in implementation. State pension spending is rising due to the ageing population. Interest expenditure on government bonds is gradually increasing due to higher interest rates: in 2028, interest expenditure is estimated to be €14.7 bln. That is €7.2 bln more than in 2023. Healthcare expenditure rises faster than GDP as we approach 2028. On average, real growth in healthcare spending is 3.0% per year over the period 2025-2028. Just under half of this growth is driven by demographic developments.

C. OPINION ON THE 2024 BUDGET MEMORANDUM

The 2024 Budget Memorandum and draft 2024 budgets are presented by a demissionary government. The government sees no budgetary scope for additional intensifications or new policies. Moreover, the government also considers this inappropriate due its current demissionary status. Thus, the budget documents are relatively limited in policy terms. The government adopted a purchasing power package to support vulnerable groups based on the results of the CPB's draft Macroeconomic Outlook.

After a purchasing power package with incidental income-support measures for autumn 2022 and for 2023, a purchasing power package with structural measures is announced in the 2024 Budget Memorandum.[5] Among others, the child budget and housing benefit will be structurally increased. A budgetary envelope is also allocated to improve purchasing power for the Caribbean Netherlands. In addition, it was decided to increase the employed person's tax credit by €115, the previously planned reduction in the young disabled person's tax credit will be scrapped and the phasing-out of the double factor in the general tax credit for people receiving benefits will be frozen. The emergency fund for people who can no longer pay their energy bills will be extended until the end of 2024.

Coverage for these measures is provided, inter alia, by a surplus in the revenue framework, by a limitation of the indexation of the starting point in the top rate of Box 1 in income tax, a limitation of the indexation of the starting point in the second bracket in Box 1 of income tax for those who are not liable to pay any or full national insurance contributions, such as pensioners,[6] an increase in alcohol excise duty and excise duty on tobacco and by deploying a surplus on the measures in the Spring Climate Package.

Given the demissionary status of the government, it was decided for the time being not to implement three outstanding tax measures from the Spring Climate Package. This includes Betalen naar Gebruik (Pay for Use), phasing out fossil subsidies and the 1.2 Mtonne CO2 reduction target through energy tax rate

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[5] In the 2023 Budget Memorandum, the government adopted an incidental purchasing power package including a temporary reduction in energy tax and an energy allowance.
[6] It not only concerns pensioners, but anyone who is not liable to pay national insurance contributions or is liable to pay limited contributions, now that, exclusively for this group, the combined income tax and national insurance contributions rate is lower than in the second bracket.

adjustments. The decisions related to these measures will be left to the next government. See Section E3 of this report for a more detailed explanation of the decisions made in the Budget Memorandum.

Reflection on cohesion with regard to broad prosperity
In the 2024 Budget Memorandum, the government explicitly focuses on broad prosperity in relation to macroeconomics and public finances. The government also devotes attention to several broad prosperity themes in Chapter 1 and Chapter 3 of the 2024 Budget Memorandum.

In the opinion accompanying the 2023 Budget Memorandum, the Advisory Division advised the government to carry out a medium-term analysis of the socio-economic structure of the Netherlands and its underlying strengths and weaknesses. The aim of such an analysis is to arrive at integrally considered choices and priorities, and is intended to support the government's and parliament's capacity to act and solve problems.

In Chapter 1 of the Budget Memorandum, the government presents an analysis of the aspects of broad prosperity. This analysis yields three insights, in which several trade-offs emerge. First, the government analysis reveals that the sustainability transition can have positive health effects and provide opportunities for the economy. But because of distributional impacts and potential consequences for people's livelihoods, it is important that people can keep up with the transition. Next, the government argues that international cooperation can help address cross-border challenges such as security and sustainability. But this can also lead to tension at the expense of livelihood security that can damage the associated trust in the government. The government concludes with the insight that strong democratic and economic institutions and security are preconditions for a high-quality knowledge economy to ensure equal opportunities and livelihood security.
In Chapter 3 of the Budget Memorandum, the government elaborates on the economic structure, stating that in an economy that generates broad prosperity, work must pay and unpaid work must also be valued; that an ageing population will cause structural shortages in the labour market and that, therefore, productivity growth is needed; that different socio-economic groups have different social positions and chances in life and that increasing equal opportunities is therefore important; and that the economy must operate within the planetary boundaries of the climate and nature.

The Advisory Division notes a gradual shift in successive Budget Memoranda from thinking in terms of economic growth to a more comprehensive approach in terms of broad prosperity. With a focus on broad prosperity in the Budget Memorandum, the concept of broad prosperity is afforded greater significance. Indeed, thinking in terms of broad prosperity encourages long-term thinking and enables us to look at the connection between different societal challenges. The Advisory Division sees the consideration in Chapter 1 and the principles outlined for increasing broad prosperity in Chapter 3 of the Budget Memorandum as a good first step, which needs more coherence and further broadening, deepening and elaboration for the next government.

The analysis of the elements of and connections between some of the themes of broad prosperity (Chapter 1) and the framework for thinking about increasing broad prosperity (Chapter 3) are not yet sufficiently connected in the Budget Memorandum. Thereby, the different steps describing, analysing, policy proposals and indicators could be differentiated and described more clearly. In addition, the considerations that formed the basis for the government's choice of the various themes in the individual analyses in the Budget Memorandum are rather ambiguous. Although the Advisory Division deems the various themes important, because of the lack of justification, it is unclear whether this completes the analysis, or whether there are certain themes that are currently missing from the analysis. Recent letters from various ministers on the labour market (SZW), economic structure (EZK), spatial planning and public housing (BZK), for example, do not seem to be part of Chapters 1 and 3; policy proposals from the aforementioned letters are also barely recognisable in this Budget Memorandum.[7]

Other perspectives also seem to be missing, for instance the focus on cooperation between central government and local and regional authorities. Social challenges almost always cross the boundaries of administrative divisions. This calls for effective intergovernmental cooperation, especially now that the implementation of important tasks such as those related to the climate and housing are largely the domain of local and regional authorities, but also calls for that perspective to be included during the analysis phase.

Advice for deepening and elaborating on broad prosperity
The concept of 'broad prosperity' underlines the fact that prosperity depends on more factors than just cyclical developments or GDP growth. It is a perspective that promotes long-term thinking and can thus act as an anchor for predictable and effective policy.[8] Steering in terms of broad prosperity involves more than focusing on one or a few indicators: the connection between dimensions of broad prosperity and the distribution between groups is important. Moreover, increasing broad prosperity requires structural solutions, precisely because of the connection between the challenges. Annual steering on separate indicators only produces limited or temporary effects.

An example is the purchasing power measures presented in the 2024 Budget Memorandum, aimed at supporting vulnerable groups. The government is taking a number of measures, with no underlying analysis in the Budget Memorandum of the causes of the poverty problem or of proven effective and feasible measures. However, making work pay and increasing equity, among other things, identified

[7] Parliamentary Documents II, 2022/23, 29544, No. 1176; Parliamentary Documents II, 2022/23, 33009, No. 131; Parliamentary Documents II, 2022/23, 32847, No. 1045.
[8] The Netherlands Institute for Social Research (2022). Reflection on the Coalition Agreement 2021-2025 from the citizen's perspective.

as challenges in Chapter 3 of the Budget Memorandum, requires structural policies and reforms in a variety of policy areas, such as the labour market and in public housing. Before policy options to reduce the number of vulnerable people can be identified, a coherent analysis of the problems, challenges and opportunities in the economic structure, the different dimensions of broad prosperity and the coherence between different policy areas is required.

The social challenges for the coming government term will influence the dimensions of broad prosperity. It is also important that long-term policies that are effective, stable, predictable and feasible are implemented. As the government itself also underlines in Chapter 3 of the Budget Memorandum: when responding to current developments, there is a risk that the focus on long-term structural analysis and policy will fade into the background.

Subsequent Budget Memoranda are expected to reflect on financial, socio-economic and environmental policies following the upcoming coalition agreement. The Advisory Division recommends the next government’s first Budget Memorandum be used for an analytical deepening of the new coalition agreement, in order to develop an ‘Initial Policy Memorandum (in terms of) Broad Prosperity’. Subsequent Budget Memoranda can then be used to monitor and possibly adjust political priorities, without compromising on the long-term focus.

D. THE IMPACT OF CLIMATE CHANGE ON PUBLIC FINANCES AND FISCAL POLICY

In this year's opinion on the Budget Memorandum, the Advisory Division calls for special attention to be devoted to the impact of climate change on public finances and fiscal policy.[9] The Advisory Division addresses this theme against the backdrop of the urgency of climate change, which is addressed several times in the draft 2024 Budget Memorandum. However, the focus on the climate in the Budget Memorandum is mainly descriptive in nature. This opinion on the Budget Memorandum aims to help flesh out the theme of "the limits to climate and nature within which the economy should be shaped", as presented in the draft 2024 Budget Memorandum.

The climate theme - alongside the theme of the ageing population - is an urgent social task in the short, medium and long term that calls for fine-tuned policy choices. However, unlike the climate, the ageing population is already part of integral considerations to a certain extent. This opinion on the Budget Memorandum examines how climate sustainability relates to the sustainability of public finances and how the integral (political) considerations of climate policy and other policies can be reinforced. To this end, the Advisory Division presents

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9 This was also a key theme of the conference of the Network of European Independent Fiscal Institutions (EUIFI Network), held at the Council of State in June 2023.

specific action perspectives for fiscal policy and the budget system for the coming years.

Section D.1. describes why climate risks also pose a risk to the budget and how they can structurally affect the composition and level of government revenue and expenditure. Section D.2. describes four elements in which adjustments are needed to make the Dutch budgetary framework climate-inclusive. These elements are a strategic framework; the budgetary instruments, methods and system; governance; and reporting and accountability. Section D.3. outlines a step-by-step approach to move towards a climate-inclusive budgetary framework and offers concrete advice, related to the four elements described above, on how to work towards a climate-inclusive budgetary framework in the coming years. The Advisory Division expressly presents a growth model; not everything is possible and needs to be done at the same time. But it is imperative that we start now.

1. Climate risks represent fiscal risks

Climate change constitutes one of the biggest, if not the greatest, societal challenges for the coming decades. Global warming will continue to increase in the short term (2021-2040), according to the IPCC, mainly due to increased cumulative CO2 emissions.[10] An increase in extreme weather events has already been reported and these are likely to intensify. According to the Broad Prosperity Monitor, which includes the climate, the natural capital indicator in the Netherlands is under pressure for future generations.[11] The Sustainable Development Goal focused on climate action shows that the Netherlands is ranked in the middle or bottom group in European comparisons for the different climate-related indicators.[12] According to the Broad Prosperity Monitor, three quarters of the Dutch population is worried about climate change.

Climate change is not a temporary problem, but requires continued attention: even if adaptation and mitigation policies[13] are ultimately successful in curbing greenhouse gas emissions, structural efforts are needed to minimise greenhouse gas emissions and keep global warming at viable levels. Moreover, climate change will lead to climate damages for citizens, businesses, insurers and governments.

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[10] IPCC (2023). Climate Change 2023. AR6 Synthesis Report

[11] Natural capital is the stock of natural resources that have the ability to provide services to people, such as water purification, natural pest protection, plant pollination and carbon sequestration; the so-called ecosystem services. Source: Netherlands Environmental Assessment Agency (2016). Natural capital in the Netherlands: Recognising its true value

[12] Statistics Netherlands (CBS) (2023). Broad Prosperity Monitor and the Sustainable Development Goals 2023.

[13] Climate adaptation refers to adapting to climate change, for example by increasing the height of dykes. Climate mitigation is the prevention of further climate change by reducing greenhouse gas emissions.

The three channels of climate change costs, namely mitigation and adaptation policies and climate damages are linked to each other, and to international efforts. They are interconnected: if mitigation policies prove unsuccessful in curbing GHG emissions, and adaptation policies are unsuccessful, the magnitude of costs due to physical damage increases. Moreover, successfully reducing greenhouse gases - and thus reducing damage and adaptation costs - can only be achieved in an international context.[14] All three channels entail costs, some of which involve the government. The extent to which the government will bear the cost is a policy choice. The national (mitigation) targets for lowering greenhouse gas reductions are set out in the Climate Act, with the Netherlands opting for a reduction target of 55% by 2030 and 100% by 2050.[15]

Climate change will be highly decisive for society, nature and health, now and in the future. According to the IPCC, almost all government policy areas such as food security, public health, agriculture, infrastructure, migration and urban development will also be affected by climate change.[16] Boosting biodiversity deserves a separate focus in this regard. If no action is taken, about one million species will become extinct.[17] Moreover, climate change and the degradation of nature are mutually reinforcing. Therefore, addressing climate change cannot be separated from the approach to boosting biodiversity. Addressing climate change - from the perspective of broad prosperity and in connection with other societal challenges - is thus explicitly a task for all governments, namely local, regional, national and supranational, and for their mutual administrative relations and division of tasks.

The economy will also be seriously impacted by climate change. For instance, according to the IMF, in the long term, persistent temperature rises and extreme weather events can negatively affect labour productivity, delay investment and damage human health.[18] According to the WTO, world trade flows could be disrupted, resulting in increased trade costs and supply shocks.[19] The ECB cites indirect inflationary effects that can occur as a result of supply shocks and by increasing instability in the financial system.[20] Structural economic change can occur as a result of changes in a country's comparative advantages and thus

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[14] CPB Netherlands Bureau for Economic Policy Analysis (2023). Climate change and intergenerational distribution of the financial burden. CPB Publication, September 2023.
[15] Climate Act, Article 2(2).
[16] IPCC (2023). Climate Change 2023. AR6 Synthesis Report
[17] Parliamentary Documents II 2019/20, 26407, No. 130.
[18] International Monetary Fund (2019). Long-Term Macroeconomic Effects of Climate Change: A Cross-Country Analysis. IMF Working Paper October 2019.
[19] World Trade Organisation (2022). Climate Change Adaptation and Trade. WTO Policy brief.
[20] European Central Bank (2023). The Climate Change Challenge and Fiscal Instruments and Policies in the EU. Occasional Paper Series No 315.

economic activities.[21] This presents both risks and opportunities.[22] Climate change (e.g. due to rising sea levels and/or drought) can also severely disrupt economic and social activities, or even make them impossible, in countries and parts of the world.[23]

For citizens and businesses, climate change may lead to reduced revenues due to the impact of climate on human health (via a deteriorating quality of nutrition, reduced learning capacity and skills development and/or reduced labour productivity)[24], or to additional costs when damage occurs to homes, businesses and other property and to disruptions or structural change in business activities due to supply or demand shocks.

These macroeconomic developments will also change the composition and level of central government revenue and expenditure. On the one hand, climate change has an impact on government budgets: if climate risks materialise in the real economy, this could impact the growth and size of the national economy and lead to reduced tax revenues. Climate damage will lead to additional costs for - among others - local and regional authorities and governments. On the other hand, local and regional authorities and governments can mitigate climate change by implementing mitigation and adaptation policies. Policy priorities and the corresponding allocation of resources will subsequently shift, resulting in structural changes in the composition of public expenditure and government revenue.[25]

Governments may also face risk regulations in the financial sector if certain assets lose value (unexpectedly) due to climate change (stranded assets). This concerns, for example, issuing government guarantees. Problems may also arise in the insurability of damage caused by disruptive climate disasters. As a result, some of the costs may be borne by the government. Together, these factors can affect a country's creditworthiness, and thus interest expenditure on government debt.[26]

In other words, the composition and level of public expenditure and government revenue and the sustainability of government debt (creditworthiness) will be

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[21] World Trade Organisation (2022). World Trade Report 2022. B: The role of trade in adapting to climate change.
[22] For example, in the future, types of agricultural activities may be possible that were unthinkable in the past. However, in the long term, the risks will outweigh the opportunities. Moreover, when it comes to the global North and South, opportunities and risks will not be equal. See: Tol, Richard. 2018. The economic impacts of climate change, Review of Environmental Economics and Policy, 12 (1): 4-25.
[23] World Economic Forum (2021). Global Risks Report 2021.
[24] Caruso, G., Marcos, I., Noy, I. (2023) 'Climate changes affect Human Capital'. CESifo Working Papers, April 2023.
[25] The revenue side of the budget is changing in several ways due to climate change. There may be an erosion of the tax base of existing tax measures, and there may be higher tax revenue in the short term as a result of carbon pricing measures. However, in the longer term this tax revenue will decrease again if their goal of reduced emissions is achieved.
[26] European Central Bank (2023). Financial Stability Review. May 2023.

affected by climate issues and risks. This has potential implications for the medium and long-term sustainability of public finances. National public finance assumptions and the budget system do not always reflect this, or make these developments transparent.

For example, unlike an ageing population, climate is not yet included in analyses of the sustainability of public finances. However, fiscal policy is an important policy determinant, whether it is the level of government revenue and expenditure, the allocation of these resources, the policy mix (subsidising, standardising or pricing), the budget balance, public debt, the sustainability of public finances or the government's financial obligations. The budget system, namely the design of the budget (budgetary rules) and of decision-making (budgetary process), must facilitate efficient and effective fiscal policy.

To account for the fundamental change in the socio-economic structure, the structural change in government revenue and expenditure and the interdependence of climate and the sustainability of public finances, it is necessary to include the climate in the fiscal policy and system to be pursued. Just as an ageing population (demographics) is an integral part of the (medium and long-term) sustainability of public finances, climate challenges should be too. Fiscal policy should be used to support climate goals and other societal goals, by enabling more effective integral consideration of climate policy in relation to other policies. To achieve this, the budget system also needs to be examined. That is how a climate-inclusive budgetary framework is created.

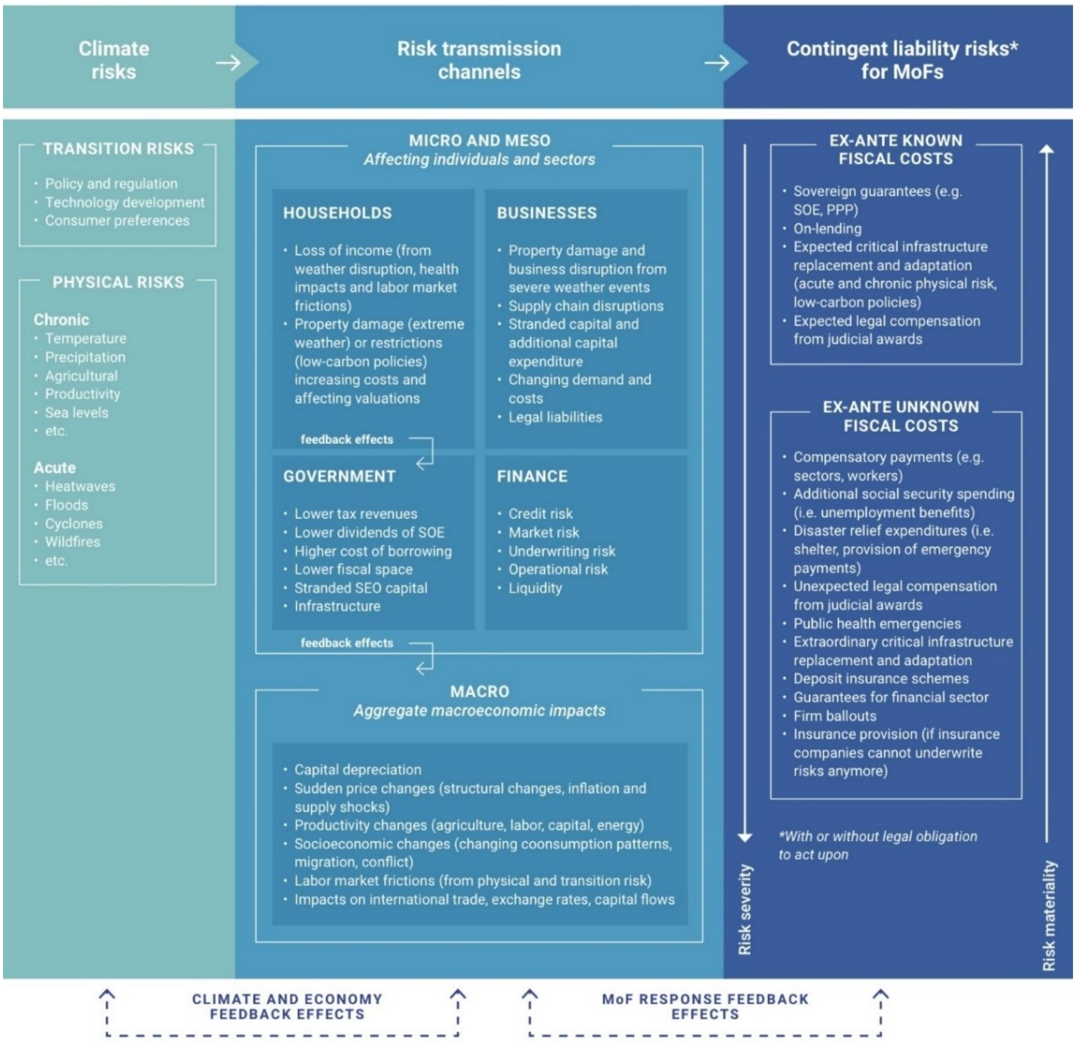

Figure 1: Climate risks, channels through which climate change manifests and potential financial liabilities for ministries of finance
Source: The Coalition of Finance Ministers for Climate Action (2023)

2. Four elements to create a climate-inclusive budgetary framework

In Europe and globally, many countries are integrating climate in fiscal policy and budget systems. At the same time, it is a relatively new field in the broader theme of fiscal policy and budget systems. To share knowledge and experience, several international partnerships exist in the scientific, institutional and political domains. Combining a number of studies, the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF) and the European

Commission have jointly identified four elements on the basis of which countries can green their existing budgetary frameworks.[27] These elements are:

i) A strategic framework,
ii) Tools, methods and budget system,
iii) Governance and
iv) Accountability and reporting.[28]

These elements can serve to make the Dutch budgetary framework climate-inclusive.

i. Strategic framework

According to the OECD, European Commission and the IMF, identifying strategic climate mitigation and adaptation policy priorities and targets and then relating them to fiscal policy principles is a first step to embedding climate in the budgetary framework.[29] This provides guidance for medium-term budgets on both the expenditure and revenue sides.

In the European context, the link between climate and fiscal policy has long been established. The objectives of Economic and Monetary Union, set out in the Maastricht Treaty in 1992 as part of the European Union's goals, not only include the establishment of a single market, balanced economic growth, price stability, employment and prosperity in the participating Member States, but also the improvement and protection of the quality of the environment.

The European Green Deal, concluded in 2019, states that national budgets play a key role in climate policy and policies aimed at the green transition.[30] The European Commission's legislative proposals for the future European budgetary framework, currently under negotiation, also address the climate. An important aspect of the legislative proposals is that Member States must compile medium-term plans every four years, which should include a fiscal target as well as relevant investments and reforms. The investments and reforms included must do justice to common EU priorities, including the European Green Deal, the transition

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[27] European Commission (2022). European Commission Green Budgeting Reference Framework; IMF (2021). Climate-Sensitive Management of Public Finances – "Green PFM". IMF Staff Climate Note 2021/002; OECD (2020). OECD Green Budgeting Framework.

[28] OECD, European Commission and IMF (2021). Green Budgeting: Towards Common Principles. November 2021.

[29] OECD, European Commission and IMF (2021). Green Budgeting: Towards Common Principles. November 2021.

[30] European Commission (2019). Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. The European Green Deal. COM(2019) 640 final.

to climate neutrality by 2050 and be translated into national energy climate plans.[31]

Dutch fiscal policy aims to support the process of allocating financial resources for policy priorities and is founded on three basic principles.[32] The first basic principle of Dutch fiscal policy is the efficient allocation of public resources. Since resources can only be spent once, public funds must be distributed as efficiently as possible between the different policy priorities. The second basic principle is the control of public finances. To avoid passing costs on to future generations, a government makes clear agreements at the beginning of a government term on what the maximum permitted expenditure is in one year (expenditure ceiling) and what the policy adjustments to taxes should be each year (revenue framework). The third principle is macroeconomic stabilisation. By pursuing trend-based fiscal policy, the revenue side of the budget basically moves in tandem with the business cycle.

Since climate risks pose a significant risk to the government budget, it is important to examine what climate change and climate mitigation and adaptation targets mean for public finances and the purpose and basic principles of fiscal policy. It will then be possible to examine how the climate can be included more effectively in fiscal policy and the budget system in order to maintain the purpose and basic principles of fiscal policy.

ii. Instruments, methods and budget system

Macroeconomic and fiscal analyses of the effects of climate change and climate policies can contribute to informed and evidence-based fiscal decision-making and the formulation of policy priorities. Subsequently, the budget system must facilitate integral considerations. Existing budgetary instruments, methods and the budget system need to be recalibrated to improve analyses and outcomes.[33] This also helps strengthen ex post accountability and reporting on the progress of climate policy. According to the OECD, European Commission and the IMF, these kinds of fiscal instruments, methods and systems should therefore be part of the existing, annual budgetary process.[34]

Defining and classifying climate policies

According to the European Green Deal, greater use of green fiscal instruments will help shift public investment, consumption and taxes towards green priorities and

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[31] European Commission (2023), Proposal for a regulation by the European Parliament and of the Council on the effective coordination of economic policies and multilateral fiscal monitoring and repealing Council Regulation (EC) No. 1466/97. COM(2023) 240 final.

[32] Ministry of Finance (2022). Fiscal rules 2022-2025.

[33] In the Netherlands, the CPB Netherlands Bureau for economic Policy Analysis is starting to collect data on the future impact and costs of climate change. See: CPB Netherlands Bureau for Economic Policy Analysis (2023). Climate change and intergenerational distribution of the financial burden. CPB Publication, September 2023.

[34] OECD, European Commission and IMF (2021). Green Budgeting: Towards Common Principles. November 2021.

away from climate-harming subsidies. Cooperation between Member States and the European Commission in benchmarking and vetting green fiscal practices can help assess the extent to which annual budgets and medium-term fiscal plans take climate considerations and risks into account, and to learn from best practices.[35]

One such fiscal instrument involves defining and classifying climate policies and their associated expenditure and taxes.[36] This is achieved by labelling expenditure, revenue and tax expenditure[37] according to their relevance to climate goals. It is important to be able to track and monitor climate policies so that resources can be allocated efficiently and effectively, and policy effects are insightful and transparent. International experience in defining and classifying climate policies show that this can also help mobilise private finance for them.[38]

In the Netherlands, under the Climate Act, the Minister for Climate and Energy Policy is tasked with providing an overview of the budgetary implications of climate policy.[39] In response to a report by the Court of Audit, the Minister for Climate and Energy Policy provided the following definition of climate expenditure: *"Climate expenditure is all expenditure whose main purpose is to contribute to national climate policy aimed at reducing greenhouse gases and making energy supplies more sustainable. This could include expenditure aimed at the production and use of GHG-neutral energy, energy savings, the direct reduction of GHG emissions or greenhouse gas sequestration."*[40]

While the Advisory Division considers adopting a clear definition of climate expenditure to be a good first step by the government to increase transparency in the climate policy pursued, the Advisory Division considers this definition too narrow. As a result, a complete overview of climate-related policies is lacking. With the definition of climate expenditure used by the government, there is a risk that not all climate expenditure related to climate mitigation will be disclosed, as only expenditure directly related to climate targets is included. In addition, only tax schemes are included (on the expenditure side) that are consistent with the above definition and only items on departmental budgets are part of the overview. This means that expenditure on climate mitigation by local and regional authorities,

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[35] European Commission (2019). Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions. The European Green Deal. COM(2019) 640 final.
[36] In the international literature, this component is called 'green budgetary tagging'. See, for example, World Bank (2021). Climate Change Budget Tagging: A Review of International Experience. February 2021.
[37] In the Dutch Budget Memorandum, tax expenditure is referred to as 'tax schemes'.
[38] World Bank (2021). Climate Change Budget Tagging: A Review of International Experience. February 2021.
[39] Climate Act Article 7(3)(c).
[40] Ministry of Economic Affairs and Climate Policy. (2023). Government response to the Court of Audit study of climate expenditure. 2 June 2023

among others, is not included in the overview of climate expenditure, even though they too bear responsibility for a part of climate policy.

Moreover, within the definition of climate expenditure, only expenditure related to climate mitigation is included. Climate adaptation, which is an important part of climate policy aimed at reducing the Netherlands' vulnerability to the effects of climate change, such as rising sea levels and extreme weather events, is not part of this overview of climate expenditure.

Estimates in expenditure on future climate damage are also omitted. The IPCC stated that as extreme weather events intensify, damage to the physical environment will increasingly be part of future climate expenditure.[41] These damages are related to mitigation and adaptation policies that are not implemented effectively or in a timely manner by the government, companies, local and regional authorities and civil society organisations. Failure to make timely and comprehensive agreements on responsibility for climate damage between individuals, businesses, insurers and the (central) government leads to potential fiscal risks.

The revenue side of the budget lacks insight into climate-related tax measures. For example, the Court of Audit notes that the government's existing climate policy overviews do not consistently report on tax schemes.[42] The Climate Memorandum, which aims to provide overarching insight into the climate policy pursued, does not provide an integral overview of climate-related tax measures.

Not only is an insight into climate expenditure and taxes that contribute to climate goals (green) relevant, but also insight into various schemes (including tax schemes) that are at odds with achieving climate goals (brown).[43] There are several initiatives in which a green and brown taxonomy is being applied in practice to better monitor and steer climate taxes and expenditure.[44][45] The 'do no

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[41] Global warming will continue to increase in the short term (2021-2040), according to the IPCC, mainly due to increased cumulative CO2 emissions. IPCC (2023). Climate Change 2023. AR6 Synthesis Report.

[42] Court of Audit (2023). Insight into climate policy expenditure.

[43] In its report on an insight into climate expenditure, the Court of Audit also noted that central government has several (tax) schemes that may be at odds with achieving climate targets.

[44] The European taxonomy is a European Commission classification methodology that defines criteria for economic activities that are consistent with climate targets and priorities under the European Green Deal.

[45] See, for example, the macroeconomic forecasts by the European Central Bank of the eurozone where fiscal measures, both on the expenditure and revenue side are classified by the ECB as 'green' or 'brown'. https://www.ecb.europa.eu/pub/economic-bulletin/focus/2023/html/ecb.ebbox202301_05~d8e33ee7ac.en.htmlSee: ECB (2023). Economic Bulletin, Issue 1, or the European Commission's two lists of budget items of net environmental impact that can broadly be considered 'green' or 'brown'. These lists are meant to be indicative and not comprehensive, but provide an example of how such a

significant harm' principle as part of the European taxonomy, applicable to funds from the Recovery and Resilience Facility, can be understood as an initiative to identify brown measures. The 'do no significant harm' principle means that no economic activities are supported or carried out that significantly harm (European formulated) climate targets.[46]

International definition and classification methodology
There are currently no globally shared and recognised definitions of government expenditure (including tax expenditure) and revenue related to the climate. International research shows that most countries working towards defining and classifying climate tax and expenditure, such as the Netherlands, start with tax and expenditure directly related to climate targets.[47] However, the World Bank pointed out the importance of developing an appropriate methodology for defining and classifying climate policies based on their purpose and potential users.[48]

An example of such a method is the European taxonomy. The taxonomy has a (crude) categorisation of sustainable activities and uses three categories to classify activities: an activity contributes substantially (100%), makes an average contribution (40%) or has no impact (0%) on identified climate goals. The three categories are used to assess investments and expenditure for six identified climate goals: climate mitigation, climate adaptation, the sustainable use and protection of water, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems. At the European level, the taxonomy has been used since 2020 to track and encourage investment and sustainable activities.[49] The taxonomy applies both to private sectors and to the spending of the European Union's own resources from the Recovery and Resilience Facility (RRF) and structural funds. In the Netherlands, the Dutch State Treasury Agency, which among other things manages the Dutch public debt, uses the European taxonomy in its green bonds framework.[50]

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classification practice could be incorporated within a national framework. See: Eurostat data "Environmental Goods and Services Sector" and "National Tax Lists".

[46] Communication from the European Commission on technical guidelines for the application of the 'do no significant harm' principle under the Recovery and Resilience Facility Regulation. OJEU 2021. C. 58, p1.

[47] United Nations Development Programme (2022). Global Climate Public Finance Review. September 2022.

[48] World Bank (2021). Climate Change Budget Tagging: A Review of International Experience. February 2021.

[49] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on establishing a framework to facilitate sustainable investment, OJEU 2020, L 198, p. 13.

[50] Dutch State Treasury Agency (2022) State of the Netherlands. Green Bond Report. May 2022.

The European taxonomy is not infallible either. The taxonomy is still rather crude, while ideally the (budgetary) information should be as refined as possible.[51] Nevertheless, the Advisory Division considers it important to take steps in further developing (an optimally refined) definition and classification methodology for climate policy. Therefore, the Advisory Division recommends that the government develop a methodology for defining and classifying climate tax and expenditure. Lessons from the European taxonomy provide tools for this task. The ultimate objective, which can be achieved in steps, is to create a comprehensive framework of, both green and brown, climate tax and expenditure so that the outcomes can provide greater transparency, more efficient and effective policies, better estimates and forecasts of climate damage, mitigation and adaptation, and thereby support integral considerations.

Greening budgetary methods
Independent macroeconomic and public finance development forecasts play an important role in Dutch fiscal policy and the budgetary process. These projections ideally form the basis for political decision-making at the start of a government term and during (key) budgetary decision-making moments.

The ability to estimate the efficiency and effectiveness of climate-related revenue and expenditure in the medium term is an important component in the development of a climate-inclusive budgetary framework. Understanding the future social costs of climate damage, mitigation and adaptation is also important. To date, the effects of climate change have hardly been part of macroeconomic and budgetary forecasts, due to their limited quantification. According to the OECD, European Commission and the IMF, the ability to take the effects of climate change into account in macroeconomic and fiscal models can improve forecasts.[52]

Analyses of the sustainability of public finances
The sustainability of public finances plays an important role in budgetary decision-making (see also Section E.1.). Climate, unlike the impact of an ageing population - partly due to limitations in the available data and methods - currently plays no or an insufficient role in current sustainability analyses.

However, the climate also involves intergenerational aspects. In a recent study on climate change and the intergenerational distribution of financial burdens, the CPB shows, based on estimates and current insights, that future generations are likely to pay a larger share of the additional costs of climate change policies than current generations. This is because the negative impact of climate change in the Netherlands is expected to increase in the future and the most difficult part of the

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[51] For criticism of the European taxonomy and the so-called Rio Markers, see the European Court of Auditors' report (2020). Tracking climate spending in the EU budget. Review 1/2020.
[52] OECD, European Commission and IMF (2021). Green Budgeting: Towards Common Principles. November 2021.

climate transition is yet to take place. This means that additional adaptation measures have to be taken, on top of existing ones.

The CPB's recent study is a first outlook on the intergenerational distribution of the costs of climate change and policies. To date, accurate cost estimates have proven complicated and subject to major uncertainties. However, this study does show that climate considerations can have substantial intergenerational effects. It demonstrates the importance of including climate effects in existing analyses of the sustainability of public finances.

Baseline
Policy considerations should not only include the effects of new policy on public finances and the impact of the tax burden on citizens and businesses, but also the so-called baseline: how will public finances evolve if policy remains unchanged? If the impact of climate change on public finances in the event policy remains unchanged is part of the baseline, the impact on public finances of any new climate-related policy decisions can be weighed against the impact on public finances if additional policies are not implemented.

Sustainability analyses that - in addition to the effects of an ageing population - also take into account the effects of climate change could lead to the conclusion that it is better to implement certain climate policies, namely investments, standardisation and pricing, for climate mitigation and adaptation in the shorter term, but at the expense of public debt in order to reduce higher costs, and real damage, in the future. Understanding the intergenerational aspects of climate policy and incorporating them in analyses of the sustainability of public finances improves the ability to make integral considerations of resource allocation in fiscal policy.

Long-term scenarios and indicators
European and national climate targets focus on 2030 and 2050. These targets are designed to limit the rise in average global temperatures to well below 2 degrees Celsius, and 1.5 degrees Celsius if possible. In climate studies, it is common practice to look beyond these years and focus on the year 2100 for modelling and projections of the effects of climate change. By using 2100 as an endpoint, trends can be modelled over a long period to identify significant changes in climate patterns, sea levels and other variables, and thereby better underpin policy.[53]

Macroeconomic and budgetary forecasts often focus on the short or medium-term. Analyses of the sustainability of public finances often look further ahead. Identifying the effects of climate change also requires a long-term approach, as the course of the effects of climate change has a longer-term horizon. Moreover, these effects are not always linear and can also be intermittent effects.

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[53] Lyon, C., Saupe, E. (2021). Climate Change Research and Action must look beyond 2100. Global Change Biology, Volume 28 (2): p.349-361.

Scenarios are usually used to gain insight into the long term. Indeed, how climate change will evolve is uncertain. Scenario studies help provide a coherent picture of possible climate effects, the uncertainties therein, and their possible implications for climate policy.[54] Technically, compiling these kinds of climate scenarios is still complicated, partly due to limitations in the data available. However, it is important to adopt a systematic approach.

European budgetary framework

The European Commission stresses the importance of understanding fiscal risks related to climate change. In the legislative proposals for the future European budgetary framework, the European Commission proposes that Member States identify the risks posed by climate change and the medium and long-term implications of mitigation and adaptation policies for public finances.

The European Commission also believes that attention should be devoted to distributional effects and that a differentiation must be made between revenue and expenditure. It also wants Member States to identify the different ways in which climate shocks and natural disasters affect the economy, public finances and potential liabilities, as well as how governments could bear or mitigate budgetary risks. According to the Commission, reliable and frequent reporting with comprehensive, useful and accessible information improves budgetary decisions. Moreover, the Commission considers it important that Member States substantiate how the budget contributes to national and international climate targets and report transparently on the methodologies used.[55]

It is not yet known how the final budgetary framework and process will be structured, as negotiations between Member States and the Commission are ongoing and the debate with and in the European Parliament still has to take place. Only when there is clarity can the implications be determined for the Dutch budgetary process, consistency with national fiscal rules and commitments to identifying the effects of climate change. However, the legislative proposals published by the European Commission endorse the importance of a climate-inclusive budgetary framework.

Budget system in the light of climate change

The Netherlands has pursued trend-based fiscal policy since 1994 (see also Section E). When a new government takes office, a real (annually indexed) ceiling for government expenditure is established, which may not be exceeded on a cumulative basis. There are currently four expenditure frameworks: Public Expenditure, Social Security, Healthcare and Investment. A fixed expenditure ceiling ensures that there is a high degree of certainty about the level of

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[54] Working with a climate change bandwidth fits with the IPCC's understanding because it works with emission scenario reports. In the Netherlands, the national Delta Programme used Delta scenarios looking ahead to 2050 and 2100.

[55] European Commission (2023), Proposal for a Council directive amending Directive 2011/85/EU on requirements for budgetary frameworks of the Member States. COM(2023) 242 final.

expenditure. This makes it possible to pursue automatic stabilisation through the revenue side.

The revenue framework sets out the cumulative tax development for citizens and businesses as a result of the measures contained in a coalition agreement.[56] This is subject to the principle of automatic stabilisation: revenue windfalls benefit the government balance, revenue shortfalls burden the government balance. In principle, the expenditure ceiling and the revenue framework will not be adjusted during the government term.

Fiscal policy and the corresponding budget system will have to take into account the impact of climate change on public finances in the coming decades. Fiscal policies and systems must be distinguished from fiscal targets: these are established politically, partly in European budgetary agreements and partly in the coalition agreement. Here the Advisory Division addresses the question of how the budget system can be structurally improved given the necessary climate inclusiveness; it does not affect the (European and national) establishment of targets.

On the expenditure side of the budget, climate is now a significant item, which also affects and will further affect other components of public expenditure (see Section D1). The Climate Fund, which provides a subsidy for greenhouse gas reduction, is currently part of the Investment Expenditure Framework.[57] There is also expenditure on climate outside the Climate Fund, not all of which has already been identified. Because (dealing with) climate change is a structural challenge, climate must be structurally embedded on the expenditure side. It is important to examine whether the methodology of a fund is the most appropriate form for structurally embedding climate in the budget system. An alternative could be a separate Climate expenditure framework to provide structural insight into climate-related expenditure within the budget. Relevant parts of the current Investment expenditure framework could be included in the Climate expenditure framework, which would also promote simplicity and transparency.

The composition of the tax side of the State budget is also changing. For instance, the greening of the tax system creates a financial challenge due to the erosion of the tax base. This is because pricing aims to modify behaviour, so if behaviour is modified according to that intention, there will be less revenue from existing taxes. This creates a tension between reducing greenhouse gas emissions and stabilising tax revenue.[58] In the future, the composition of government revenue will structurally change, partly because tax revenue from fossil energy

[56] Tax expenditure such as losses or deferral of tax revenue is part of the budget's revenue framework.
[57] The Climate Fund, established by the Fourth Rutte cabinet, contains €35 billion for the purpose of greenhouse gas reduction. On 6 July 2023, the Temporary Climate Fund Act was passed in the House of Representatives. The vote in the Senate is yet to take place.
[58] Interdepartmental Climate Policy Research (2023). Sharp goals, sharp choices: Additional normative and pricing national climate policy for 2030 and 2050.

will disappear. Therefore, it is important to look at a sustainable structure of the revenue side of the budget and the related budgetary rules.

If the budget system is viewed partly from the perspective of climate change, it takes into account the potentially structural changing nature of public revenue and expenditure. Past experience shows that when shocks are too severe and abrupt to be absorbed by automatic stabilisation, ad hoc austerity measures or discretionary fiscal policies are implemented.[59] A future-proof budget system should be designed to be able to absorb shocks to make automatic stabilisation work, also in the future.

Budgetary process in the light of climate change
The national budgetary process, with a single integral main decision-making moment in the spring for the main lines of both the expenditure and tax side of the budget ensures administrative calm and stability in budgetary decision-making. At that time, various political wishes, problems, windfalls and setbacks on the expenditure and revenue side can be weighed up in an integral manner. This is important, for example, with regard to themes related to climate change, given the costs and benefits of climate change often fall on the domains of different departments (see also Section E).

To effectively include climate as an integral part of the decision-making process, it is important that the budgetary process promotes it and that the right budgetary information is available during decision-making moments. This also promotes an integral consideration of the different climate policy instruments, namely subsidies, standardisation and pricing. Currently, the Minister for Climate and Energy Policy is looking into ways to better align the cycle of the Climate Act with the budget cycle.[60] The Advisory Division stresses the importance of cohesion in the cycles of the budget and the Climate Act.[61] Not only does this speed up an orderly budgetary process, it also provides a single moment for integrally weighing up all the costs and benefits and possible instruments to achieve (climate) targets.

iii. Governance

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[59] During the Covid-19 crisis, the government took temporary discretionary emergency measures, such as the Temporary emergency bridging measure for sustained employment (NOW) and the Temporary bridging measure for self-employed professionals (TOZO). During the financial and eurozone crisis, the government actively pursued loose fiscal policy in 2009 and 2010, but reversed the easing in the following years with budget deficit-reducing measures that adversely affected allocation efficiency. See also: 14th, 15th and 16th Study Group on Fiscal Policy. And see: Van Es, F, I. van Tilburg and J. Lukkezen (2016), De impact van de overheid op de economie tijdens de grote recessie (The impact of government on the economy during the Great Recession), CPB Background Paper.
[60] Parliamentary Documents II 2022/23, 36169, No. 6.
[61] Opinion of 30 September 2021 on the draft Climate Memorandum 2021, (W18.21.0275/IV), annex to Parliamentary Documents II 2021/22, 32813, No 901.

The OECD, European Commission and the IMF stress that a climate-inclusive budgetary framework requires an institutional context in which roles and responsibilities are clearly defined, along with a time horizon for climate targets, and are embedded in a climate-responsible legislative framework.[62] Ministries of Finance have traditionally played a key role in the policy process because general government policy is translated into financial and fiscal policy. They also coordinate public expenditure and are responsible for tax legislation.

This places Ministries of Finance in an important position to help achieve the climate goals and the transition to a climate-resilient economy through fiscal policy, public finances and tax legislation. Close cooperation with the ministry responsible for climate policy - in the Netherlands, the Ministry of Economic Affairs and Climate Policy - and other relevant ministries and institutional stakeholders, such as assessment agencies, is self-evident; it is particularly important that the climate inclusiveness of public finances is seen as a joint responsibility.

This is also endorsed by the Coalition of Finance Ministers for Climate Action, of which the Netherlands has been a member since 2019 and co-chair as of 2023. The Coalition is an international alliance of 80 countries that aims to promote national climate goals through fiscal policy and public finances. The Coalition has formulated six principles ('Helsinki Principles') by which Ministries of Finance can align their policies and positions with the climate goals formulated.[63]

The Coalition's latest report sets out how effective climate policy can help deliver on the Finance Ministries' key priorities. To enhance the effectiveness of climate policy through fiscal policy and the use of public finances, the Coalition advocates for Finance Ministries to look for opportunities to incorporate climate policy in their core functions to enhance their capacity to act. As a result, they can ensure that climate policies become part of sound and prudent economic and fiscal policies. [64]

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[62] OECD, European Commission and IMF (2021). Green Budgeting: Towards Common Principles. November 2021.

[63] The six principles are: i) Align policies and practices with the Paris Agreement commitments, ii) Share experience and expertise with each other in order to provide mutual encouragement and promote collective understanding of policies and practices for climate action, iii) Work towards measures that result in effective carbon pricing, iv) Take climate change into account in macroeconomic policy, fiscal planning, budgeting, public investment management, and procurement practices, v) Mobilise private sources of climate finance by facilitating investments and the development of a financial sector which supports climate mitigation and adaptation, and vi) Actively engage in the domestic preparation and implementation of Nationally Determined Contributions (NDCs) submitted under the Paris Agreement. The principles are formulated as ambitions and serve to underline the international commonality of the climate challenge, and the role of Finance Ministers therein.

[64] The Coalition of Finance Ministers for Climate Action (2023). Strengthening the Role of Ministries of Finance in Driving Climate Action. A Framework and Guide for Ministers and Ministries of Finance. Final Report June 2023.

Therefore, it makes sense for the Dutch Minister of Finance to play a coordinating role in embedding the climate theme in the budget system: the Ministry of Finance has the knowledge, skills and institutional support for developing, implementing and coordinating budgetary standards.[65] This coordinating role regarding the budget system will then have to be fulfilled in association with the Minister responsible for Climate and Energy Policy.

A climate-inclusive budgetary framework also requires knowledge and cooperation with other institutional stakeholders in climate policy. Therefore, the development of a climate-inclusive budgetary framework will affect the work of multiple levels of government, departments and knowledge institutions. Involving independent institutions such as the Netherlands Bureau for Economic Policy Analysis (CPB), the Netherlands Environmental Assessment Agency, Statistics Netherlands and the Court of Audit is also important. These institutions play an important role in producing, for example, analyses, forecasts, methods, calculations and evaluations.

It may thus be helpful to clarify the different roles and responsibilities, including the different methods, instruments, rules and system required (see also Section D.2.ii). To enable steering on climate targets, it is important that sufficient information is available to perform considerations (see also Section D.2.ii) and that the various analyses of different institutions are available in time. It may also help to make mandates explicit for certain institutional stakeholders, or where appropriate, consider whether existing mandates should be revised.[66] When there is a clear mandate, there is authority to act. Furthermore, mandates help ensure that resources and expertise are available.

Mandates can also be legally anchored. In the Dutch context, fiscal policy and the budget system are legally anchored in the Sustainable Public Finances Act (Wet Houdbare Overheidsfinanciën, 'Wet HOF'). In the Netherlands, international climate agreements are legally anchored in the Climate Act, in which the government has established climate-related targets.

International experience shows that a key prerequisite for implementing a climate-inclusive budgetary framework is a well-designed legal framework that supports the integration of climate targets in budgetary processes.[67] Legally embedding climate policy in the budgetary framework could be achieved in different ways, depending on the country-specific context. This could be in quantitative[68] or

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[65] OECD, European Commission and IMF (2021). Green Budgeting: Towards Common Principles. November 2021.
[66] The Coalition of Finance Ministers for Climate Action (2023). Strengthening the Role of Ministries of Finance in Driving Climate Action. A Framework and Guide for Ministers and Ministries of Finance. Final Report June 2023.
[67] United Nations Development Programme (2022). Global Climate Public Finance Review. September 2022.
[68] For example, South Korea has legislated that the impact of climate adaptation and mitigation on national budgets must be reflected annually in the budget.

qualitative terms, for example[69]. It could be a factor providing an incentive for phasing in reforms aimed at greening the budgetary framework. In order to reinforce the substantive link between fiscal policy and climate adaptation and mitigation policies and avoid regulatory fragmentation, it could be considered whether and how climate targets in relation to fiscal policy and the budget system could be legislated in the Sustainable Public Finances Act (Wet Houdbare Overheidsfinanciën, 'Wet HOF').

Local and regional authorities and state holdings are also responsible for some climate policy and/or have an impact on the climate through their activities. The OECD, European Commission and the IMF highlight the importance of including them in climate policies and making them part of the budget system.[70] In the Dutch context, local and regional authorities are highly involved in implementing climate policy and their involvement is significant. Consider, for example, the tasks of local and regional authorities in the fields of spatial planning, nature and housing, and on whom an important part of the implementation and also design of climate policy rests and who have the most direct relationship with citizens.

At the same time, there are also limits to the policy and implementation capacities of local and regional authorities. This means a climate-responsive budgetary framework must also be thought through from the perspective of (national) intergovernmental relations. The climate challenge requires direction and cohesion, driven by a nationally led approach, with changing intergovernmental relations.

iv. Accountability and reporting

Transparency and accountability are crucial values in controlling public funds. Reliable and regular reporting with consistent, comprehensive, integral, usable and accessible information on the progress of climate targets can be used by parliament, citizens and the media to form opinions on (budgetary) decision-making. When creating a climate-inclusive budgetary framework, ways should be explored to adapt existing accountability and reporting systems so that climate considerations are accounted for and communicated transparently and coherently.

Climate as part of the reporting system

The reporting system is the set of rules and principles that govern how financial transactions are administered for financial reporting purposes. As such, it is a tool for steering government objectives such as controlling the State budget and spending resources efficiently. Parliament and society use the information to perform their monitoring and legislative functions.[71]

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[69] In the Philippines, the law stipulates that the budgeting and control of public funds must ensure the proper prioritisation and allocation of resources for programmes to support climate mitigation and adaptation.

[70] OECD, European Commission and IMF (2021). Green Budgeting: Towards Common Principles. November 2021.

[71] 16th Study Group on Fiscal Policy (2020). Koers bepalen. Kiezen in tijden van budgettaire krapte. (Setting the course - Decisions in times of budgetary constraint)

In 2023, the Corporate Sustainability Reporting Directive (CSRD) entered into force for companies.[72] This European directive contains reporting requirements for including social and sustainability information in their annual reports. The obligations aim to ensure that investors and other stakeholders have access to information on companies' human and environmental impacts and to assess financial risks and opportunities due to climate change. Under the CSRD, from 2024, the first companies will be required to report on climate developments that lead to potential financial risks for the company, but also on the environmental and social impact of business activities on people and the environment. This is called the double materiality principle. The European taxonomy is an important part of the reporting requirements under the CSRD.[73]

As companies are required to disclose (sustainable and harmful) activities and potential risks to operations, the private sector is encouraged to undertake more sustainable activities. The CSRD thus provides a climate-inclusive reporting obligation for (part of) the private sector. These climate-inclusive reporting obligations do not apply to (European and national) public organisations, but they do apply to state holdings.

Due to the heterogeneity of reporting systems, no single system has been identified in the international literature on a climate-inclusive budgetary framework that leads to optimal reporting and accountability. The advantages and disadvantages that CSRD reporting practices might have for national, local and regional authorities and governments could be examined as part of a climate-inclusive budgetary framework. The double materiality principle can be included, consisting of both the fiscal risks due to climate change and the impact of government and government policies on climate, namely own carbon emissions, indirect emissions and value chain emissions.

The Advisory Division has previously advised on future-proofing central government's financial infrastructure.[74] This is against the backdrop of increasing social and international awareness that the public values of organisations cannot be measured purely by financial information. Organisations may be asked to account for how they contribute to sustainability, social inclusion and operational integrity. A climate-inclusive budgetary framework underlines the importance of bringing central government's financial accountability system up to date. Allowing climate-relevant information to flow back from the reporting system into budgetary decision-making, as part of a climate-inclusive budgetary framework,

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[72] The Corporate Sustainability Reporting Directive applies to all large listed companies and all companies listed on the regulated market. Listed micro-enterprises are excluded. In Europe, it involves nearly 50,000 companies. See: European Parliament and Council Directive (EU) 2022/2464 on corporate sustainability reporting. OJEU 2022, L 322/15.
[73] European Parliament and Council Directive (EU) 2022/2464 on corporate sustainability reporting. OJEU 2022, L 322/15.
[74] Draft Budget Memorandum Opinion 2022, Parliamentary Documents II 2021/22, 35925, No. 3

will also allow the information to be relevant ex ante, not just ex post in the accountability.

Climate effects as part of the evaluation system
There are several instruments for understanding the operation, effectiveness and efficiency of policy. The government-wide evaluation system uses various instruments to evaluate policies before their introduction *(ex ante)*, during implementation *(ex durante)* and after the policy has ended *(ex post)*. Policy evaluations and impact assessments contribute to the quality of policies by allowing better-informed choices to be made during policy-making. Understanding policy effects is essential for steering in terms of (climate) goals.

The OECD points out that including climate effects in the different stages of policy preparation and evaluation allows governments to include the climate impact of policy proposals, in addition to considerations of their effectiveness and efficiency.[75] Where relevant to policy proposals, ways to make climate effects an explicit part of policy preparation or policy evaluations could be explored.

3. Recommendations for a climate-inclusive budgetary framework

Society, nature, health, the economy and public finances will be seriously affected by climate change. The composition of government revenue and expenditure will structurally change in the process. Therefore, the effects of climate change require a continued focus. However, these elements are not yet sufficiently part of the current budgetary framework, which hampers an integral consideration of policies related to climate adaptation or mitigation in relation to other policy priorities.

The risk climate change poses to public finances is widely recognised internationally. There is growing consensus in the international literature that climate-inclusive budgetary frameworks should take into account the entire budget cycle and all public sector tax and expenditure, including those of local and regional authorities and state holdings. The legislative proposals published by the European Commission to adjust the European budgetary framework also endorse the importance of a climate-inclusive budgetary framework. At the same time, there is no blueprint for making budgetary frameworks climate-inclusive; each country will have to examine what fits with already existing budgetary frameworks and the institutional context.

The development of a climate-inclusive budgetary framework does not require an entirely new approach, but presupposes an adaptation of existing processes, methods and systems. Therefore, the development of a climate-inclusive budgetary framework is best viewed as a growth model, to be developed step by

[75] OECD (2022). Green Budgeting: A way forward. OECD Journal on Budgeting, volume 2022 Issue 2.

step. Not everything is possible and needs to be done at the same time. But it is imperative that we start now.

This development is not without its challenges. International experience shows that a robust methodology for quantifying climate effects is a complex exercise. In addition, a lack of political commitment and a lack of people, resources and knowledge is a major challenge in implementing a climate-inclusive budgetary framework, according to the OECD, the European Commission and the IMF.[76] These challenges are also expected to be relevant in the Dutch context.

The previous section identified four basic elements for shaping a climate-inclusive budgetary framework and then applied them to the existing Dutch budgetary framework.[77] A first step involves developing a strategic framework by linking climate policy priorities and targets to the purpose and basic principles of fiscal policy. This will make it possible to identify how climate change affects current fiscal policy and how the climate can be integrated more effectively in fiscal policy.

In order to make fiscal policy more climate-inclusive, independent, relevant and reliable information should be made available in a timely manner so that integral considerations can be made with regard to fiscal policy. Therefore, a second step involves defining and classifying climate policies more effectively, to make climate costs for climate mitigation, adaptation and damage transparent, including in the long term, and incorporating climate (scenarios) in macroeconomic and public finance forecasts, including in the sustainability balance and the baseline. Furthermore, it is necessary to integrate the climate in the budget system (both on the expenditure and the tax side of the budget), namely in the budgetary rules and the budgetary process, in order to facilitate comprehensive, efficient and effective considerations by politicians within fiscal policy.

A third step is the establishment of an institutional context, in which roles and tasks are defined and, where necessary, legally anchored. In this regard, it makes sense for the Minister of Finance to play a coordinating role in embedding the climate theme in the budget system, in association with the Minister for Climate and Energy Policy. A fourth step is to sufficiently integrate climate in the evaluation and reporting system. In doing so, not only individual measures should be considered, but also the connection between climate and other policy proposals.

There is an inextricable link between the elements required for a climate-inclusive budgetary framework. Enhancing just a few rather than all the elements risks the

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[76] OECD, European Commission and IMF (2021). Green Budgeting: Towards Common Principles. November 2021.

[77] The Dutch budgetary framework (budget system and process) also applies to the Kingdom of the Netherlands' expenditure on the Caribbean Netherlands. Expenditure on Kingdom Relations and from the BES fund is presented annually as an annex to the budget chapter of the Ministry of the Interior and Kingdom Relations.

achievement of any discernible or lasting improvements. For example, investment can be made in developing a definition and classification methodology for climate-related tax and expenditure, but without a generally developed strategic framework, there is a risk that the methodology developed will not adequately address the need to promote integral considerations.

The Advisory Division recommends a step-by-step approach, using a growth model, as not all the steps can be taken at the same time. Because of the interdependence of the four elements, the growth model addresses adjustments to all the elements, but recognises that not all adjustments to the existing elements can be made at the same time, and that not everything has to be done at the same time. While some adjustments to the existing budgetary framework can be implemented relatively quickly, others require more careful preparation, are technically challenging or are relatively labour-intensive. However, political commitment is key throughout the adjustment process.

It is expected that the improvement proposals will require considerable effort, especially as they are in addition to existing tasks and challenges. The phased approach must ensure that the improvements are feasible. A phased approach enables a gradual evaluation of the elements that work and those that do not.

Ultimately, it is also important to examine the social impact of government policy on the climate. This step goes beyond the design of the budgetary framework. It assumes a reciprocal approach; not only the impact of the climate on public finances and fiscal policy is relevant; the impact of government policy on the climate is relevant too.[78] This dimension focuses on the social impact of policy choices on the climate. The reciprocal approach promotes an examination of the relationship between policy choices and social outcomes, in terms of broad prosperity. This is consistent with the trend of approaching policy more from the perspective of broad prosperity.

Table 5: Growth model for a climate-inclusive budgetary framework[79]

Element	**Basic variant**	**Progressed**	**Advanced**
Strategic framework	Shaping the strategic framework: relating climate goals to the purpose and basic principles of fiscal policy.		

[78] It is similar to the so-called double materiality principle of the European private sector reporting requirements, the Corporate Sustainability Reporting Directive. See also Section iv. Reporting and accountability for this opinion.

[79] This model is inspired by a combination of the reference model for a climate-inclusive budgetary framework published by the European Commission, the IMF and the OECD. The elements presented by these organisations have been translated to the Dutch national context and proposed in a phased approach.

Instruments, methods, system	Defining and classifying mitigation and adaptation measures (expenditure and revenue). Integrating (the first-order effects of) climate into the sustainability analyses and the baseline. Making climate part of the budget system.	Extending the definition and classification method to measures that are at odds with climate targets (brown and expenditure and revenue) and to local and regional authorities. Including first and second-order effects of climate change in sustainability analyses and the baseline.	Extending the definition and classification method to state holdings. Ex ante and ex post impact assessments of mitigation and adaptation measures on public finances. Scenarios of the effects of climate change and climate policies on public finances with interaction effects.
Governance	Placing the responsibility for coordinating a climate-inclusive budgetary framework with the Ministry of Finance in association with the Minister for Climate and Energy Policy. Embedding the climate-inclusive budgetary framework in the Sustainable Public Finances Act (Wet Houdbare Overheidsfinanciën, 'Wet HOF').	Making mandates of institutional stakeholders explicit and revising them where necessary. Structuring the institutional involvement of local and regional authorities.	Institutional involvement of all relevant actors.
Accountability and reporting	Exploring what lessons the European Corporate Sustainability Reporting Directive has for greening central government's reporting system.	Implementing a climate-inclusive reporting and evaluation system.	

The Advisory Division views the elements cited in the basic variant as initial starting points for creating a climate-inclusive budgetary framework. This leads to the following specific recommendations for the coming years:

I. Develop a strategic framework

Identify how climate policy priorities and objectives relate to the purpose and basic principles of fiscal policy. In doing so, identify ways in which climate change affects current fiscal policy and where it is better to integrate climate in fiscal policy.

II. Work towards a (more comprehensive) definition and classification methodology for climate-related revenue and expenditure

To implement efficient and effective policy, climate policy needs to be quantified. The government has taken a good first step by adopting a definition of climate expenditure. However, follow-up steps are needed to define and classify climate-related revenue and expenditure for both the mitigation and adaptation policies implemented. This could include experiences from European practice.

III. Develop climate-inclusive macroeconomic and budgetary models and analyses

To better understand the development of the economy and public finances in the medium and long term, independent forecasts and scenario analyses of the effects of climate change are needed, as well as an understanding of the (future) costs of climate damage, adaptation and mitigation.

The Advisory Division recommends integrating the effects of climate change in the analyses of the sustainability of public finances and in the baseline. This means the climate can be part of integral budgetary decision-making considerations.

IV. Make the budget system climate-inclusive

The Advisory Division recommends exploring whether a Climate expenditure framework could provide structural insight into climate-related expenditure in the budget and promote integral considerations.

On the tax side of the budget, the Advisory Division recommends examining which fiscal rules on the tax side could contribute to a sustainable design of the tax system so that tax revenues are stable in the future. In addition, ensure that the cycle of the Climate Act is effectively aligned with the budget cycle. For further explanation of the above points, see Section E.1.

V. Structure the institutional context to ensure a climate-inclusive budgetary framework

Defining roles and responsibilities for the individual elements of a climate-inclusive budgetary framework provides a mandate to act. To shape the institutional context in such a way that a climate-inclusive budgetary framework is safeguarded, the Advisory Division recommends that responsibility for a climate-inclusive budgetary framework be placed centrally with the Ministry of Finance, in association with the Minister for Climate and Energy Policy. In addition, the Advisory Division recommends considering how the climate-inclusive budgetary framework can be legally anchored in the Sustainable Public Finances Act (Wet Houdbare Overheidsfinanciën, 'Wet HOF').

VI. Explore how to make the reporting system climate-inclusive

As part of a climate-inclusive budgetary framework, the Advisory Division recommends exploring what lessons the European Corporate Sustainability Reporting Directive - which applies to the private sector - offers for greening central government's reporting system.

E. 2023 SEPTEMBER REPORT

1. Recommendations for future fiscal policy

After the upcoming elections to the House of Representatives, a new government will formulate the fiscal policy to be pursued and the fiscal rules for the upcoming government term. Developments pertaining to public finances in the medium and long term, as well as the initial financial position are relevant in this process. In previous opinions on the Budget Memorandum, the Advisory Division pointed out that unambiguous anchors for fiscal policy (also) serve a democratic interest and reinforce parliamentary rights associated with the budget.[80]

In the coming decades, climate change and an ageing population are the main developments leading to structural changes in society and the economy. These developments will thus also lead to structural changes in government policies and public finances; hence the importance of a proper financial, economic, social and environmental structural analysis (see also Section C).

During the upcoming government term, it is also important that fiscal policy can contribute to citizens' confidence in the effective provision of public services and policy intentions. The current state of public finances and the outlook for the coming years are relevant in this regard (see also Section B2).

Given the current baseline situation of public finances and the medium-term economic and budgetary forecasts, prudent fiscal policy will be needed during the upcoming government term (see Sections B and E). In other words, in a new coalition agreement, establish fiscal policy for the tax and expenditure sides so that in the event of unexpected budgetary setbacks, or economic shocks or downturns, there is no need to immediately spending cuts and intervene in the (implementation of) public services. Comply with established national and European agreements, both on fiscal rules and the budgetary process.

Bearing this in mind, the Advisory Division issues the following advice for future fiscal policy:

I. *When choosing a budgetary anchor, provide ample budgetary scope to ensure the automatic stabilisation function of the budget can do its job.*

[80] See, inter alia, the Advisory Division's opinion on the 2022 Budget Memorandum

This avoids mid-term adjustments, which serves a democratic and societal interest: predictable policy and stable implementation for the medium term.

Since 1994, successive governments have opted to implement trend-based fiscal policy. On the expenditure side, expenditure frameworks are established for the entire government term, each with an annual expenditure ceiling that may not be exceeded. However, the individual expenditure ceilings are indexed annually in relation to wage and price development. On the revenue side a revenue framework applies with automatic stabilisation: revenue windfalls benefit the government balance, revenue shortfalls burden the government balance.

Consequently, in principle, fluctuations in revenue due to cyclical developments do not lead to a policy adjustment. This creates automatic stabilisation in the budget system: the revenue side of the budget moves in tandem with the business cycle so that trends in the economic cycle are automatically mitigated. In principle, the expenditure ceiling and the revenue framework will not be adjusted during the government term, which means that the frameworks set policy-based upper limits for public finances. If necessary, as during the Covid-19 crisis, discretionary policies can be implemented in addition to automatic stabilisation.

Expected government revenue and expenditure in the short, medium and long term that are the result of the coalition agreement and previously agreed policy decisions are ultimately translated into the various budgetary indicators, such as the (structural) EMU balance, EMU debt, the sustainability balance and the expenditure rule. Pursuing trend-based fiscal policy does not guarantee a certain outcome with regard to compliance with European fiscal targets.

The purpose of enforcing national fiscal rules is to ensure that public finances remain within the limits of what the government deems acceptable, given the European fiscal agreements. In other words, the decision to establish the level of the budgetary frameworks on the tax and expenditure side and a quantitative budgetary anchor at the beginning of a government term is a political choice.

In the 2023 Spring Report, the Advisory Division noted that the government is sailing close to the wind with a budget deficit of around 3% of GDP, the agreed limit for the maximum budget deficit within the corrective arm of the Stability and Growth Pact. This does not provide enough budgetary scope for a subsequent government term and lacks any buffers to absorb economic setbacks.[81]

If the new government does not stay well below European limits with the budgetary frameworks to be established and thus the quantitative budgetary anchor, there will be no scope for the automatic stabilisers to operate on the revenue side of the budget. The fact that this situation is not unthinkable is revealed by the CPB's medium-term forecast for 2025-2028: the EMU deficit rises to -3.9% of GDP if policy remains unchanged. This means that buffers are

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[81] 2023 Spring Report, Parliamentary Documents II, 2022/23, 36350, No. B

currently lacking for the implementation of trend-based fiscal policy and therefore ad hoc spending cuts or tax increases may be necessary.

Implementing trend-based fiscal policy with a budgetary anchor that allows scope for this expressly serves a democratic and social interest. When an expenditure ceiling and revenue framework can be established for the entire government term, there is insight into and certainty about the level of government expenditure and the tax burden, and interim adjustments involving spending cuts or tax increases can be avoided. This can promote stable and predictable policy and implementation so that citizens and businesses, as well as implementing organisations, are afforded relative medium-term certainty.

II. *Make climate part of fiscal policy considerations by incorporating the climate in analyses of the sustainability of public finances.*

It is relevant to consider the medium and long-term sustainability of public finances in fiscal policy considerations. Sustainability and thus a fair distribution of the benefits and costs between generations play a role in both Dutch and European fiscal policy.

When one talks of sustainable public finances in relation to fiscal policy, it generally means that it is sustainable if public policy treats different generations equally, i.e. current and future generations can benefit from public services to the same extent and face an equally high effective tax and contribution burden.

The projected development of government debt in the future is relevant when assessing the sustainability of public finances. This includes factors such as economic growth, demographic changes and interest rate developments.[82] Social transitions also impact future generations (see also Section D). Current sustainability studies try and take future costs of an ageing population into account.

For instance, current sustainability analyses, which already partly include an ageing population, may lead to the conclusion to keep government debt lower in the short term so that the costs of an ageing population can be covered in the longer term by allowing the debt to increase at that time. In contrast, the effects of climate change and climate policies are not yet included in the sustainability analyses, or not to a sufficient extent. However, the climate also involves intergenerational aspects. Sustainability analyses that also take climate into account could lead to the conclusion that it is better to implement certain climate policies, namely investments, standardisation and pricing, for climate mitigation

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[82] The CPB regularly studies the projected development of public finances in the medium term (T+8). Every four to five years, the CPB publishes a study that looks at the long-term sustainability of public finances (2060 and beyond). The European Commission publishes an annual sustainability monitor. The S2 indicator measures how much budgetary scope a Member State needs to stabilise government debt in the long term.

and adaptation in the shorter term but at the expense of government debt to reduce higher costs, and real damage, in the future.

The fact that climate is not sufficiently included in current sustainability analysis is partly due to limitations in the available data and analyses on climate damages, mitigation and adaptation.[83] Another cause, according to the CPB, is an overly narrow definition of the concept of net public benefit, which excludes public investment in, for example, education and climate with effects on productivity and incomes.[84]

Understanding the intergenerational aspects of climate policy and incorporating them in analyses of the sustainability of public finances improves the ability to make integral considerations of resource allocation in fiscal policy. Such analyses are important but not straightforward.

III. *Make the budget system climate-inclusive*

Preventing and adapting to climate change is an extensive structural challenge, affecting almost all government policy areas. The composition and level of government revenue and expenditure will change structurally and significantly. Therefore, we need to structurally embed climate in the budget system (see also Section D).

On the expenditure side of the budget, climate is now a significant item. The Climate Fund, which provides subsidies for greenhouse gas reduction (climate mitigation), is currently part of the Investment expenditure framework.[85] There is also expenditure on climate outside the Climate Fund, not all of which has already been identified (see also the section on defining and classifying climate policy in Section D). By explicitly positioning climate on the expenditure side of the budget, considerations for allocating funds for the climate become more transparent, benefiting the implementation of parliamentary rights associated with the budget. This also promotes the integral consideration of climate tax and expenditure when a new government takes office as well as during the annual main decision-making moment.

The Advisory Division recommends exploring whether a Climate expenditure framework could provide structural insight into climate-related expenditure in the budget and promote integral considerations, as is already the case for expenditure in the Social Security and Healthcare frameworks. Relevant parts of the

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[83] CPB Netherlands Bureau for Economic Policy Analysis (2023). Climate change and intergenerational distribution of the financial burden. CPB Publication, September 2023.
[84] CPB Netherlands Bureau for Economic Policy Analysis (2021). How do we measure whether public finances are sustainable? CPB Background paper, December 2021.
[85] The Climate Fund, established by the Fourth Rutte cabinet, contains €35 billion for the purpose of greenhouse gas reduction. On 6 July 2023, the Temporary Climate Fund Act was passed in the House of Representatives. The vote in the Senate is yet to take place.

Investment expenditure framework could be included in the Climate expenditure framework (which would also promote simplicity and transparency).

The composition of the tax side of the State budget is also changing in structural terms, partly because tax revenue from fossil energy will disappear. Under current fiscal rules, the greening of the tax system leads to a fiscal challenge due to the erosion of the tax base (see also Section D). This creates a tension between reducing greenhouse gas emissions and stabilising tax revenue.[86] The Advisory Division recommends examining which fiscal rules on the tax side could contribute to a sustainable design of the tax system so that tax revenues are stable in the future.

IV. *Elaborate political ambitions and priorities in terms of the dimensions of broad prosperity and use the next government's first Budget Memorandum for an analytical deepening of the coalition agreement, in order to develop an 'Initial Policy Memorandum (in terms of) Broad Prosperity'.*

Today's societal challenges extend beyond individual measures and need to be considered in conjunction. Elaborating political ambitions and priorities in terms of the dimensions of broad prosperity places the focus on interdependence and the long term and argues that prosperity depends on more factors than just cyclical developments or GDP growth. Moreover, the concept of broad prosperity is indeed being fleshed out in terms of form and content, including as a result of indicators.[87] Elaborating broad prosperity can enhance the feasibility of policy, for citizens and for implementing organisations, and enables monitoring of political priorities (see also Section C).

The Advisory Division recommends the next government's first Budget Memorandum be used for an analytical deepening of the new coalition agreement, in order to develop an 'Initial Policy Memorandum (in terms of) Broad Prosperity'. Subsequent Budget Memoranda can then be used to monitor and possibly adjust political priorities, without compromising on the long-term focus.

V. *The quality of public finances is important for achieving societal goals. Take second and third-order effects and implementation implications into account when justifying policy choices and working out their funding.*

High quality public finances are essential for the effective and efficient deployment of public resources. Several tools exist to evaluate policies ex ante, ex durante and ex post. For instance, Interdepartmental Policy Reviews (IBOs) take place annually, examining alternatives to existing policies. Potential savings are periodically identified through reviews. Besides an extensive evaluation system at

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[86] Interdepartmental Climate Policy Research (2023). Sharp goals, sharp choices: Additional normative and pricing national climate policy for 2030 and 2050.
[87] CPB, PBL and SCP (2022). Anchoring broad prosperity in the budget system. Progress report of the three joint assessment agencies. 30 June 2022.

various stages of policy and legislation, cabinets have at their disposal numerous (policy) opinions and reports from independent study groups, commissions, assessment agencies and advisory councils, among others.

Nonetheless, in the (recent) past, funding allocation has regularly been achieved using the 'cheese slicer method', by underspending or withholding funds for the wage and price adjustment.[88] The use of such methods can be counterproductive, as they usually do not compel the adjustment of policy objectives to bring them in line with the spending cuts made. The original policy objectives remain undiminished, but must be achieved with fewer resources. It is not rare for this to come at the expense of the quality of implementation or ultimately, for the budgeted spending cuts not to be achieved.

The reduction measures list and the corresponding tax measures list, which are usually prepared by the Ministry of Finance in the run-up to parliamentary elections to the House of Representatives, respectively include a list of options to reduce government expenditure in the state budget, healthcare and social security and a list to increase tax revenue. The lists contain a large number of options to terminate or scale down policies. They vary greatly in size (amount) and nature.

The individual measures did not take into account second and third-order effects[89] and did not undergo an implementation test. The tax measures on the tax measures list lack a comprehensive vision of the tax system on the basis of which, ideally, such reduction measures should take place and in which, for example, the effects on climate policy are also taken into account.[90] As a result, the consequences of policy options are not easy to assess, especially in terms of implementation, and measures from such lists may have counterproductive effects.

However, mapping the relationship between different measures, second and third-order effects and consequences for implementation is highly relevant. Indeed, social challenges are complex and are often closely related. Implementation is also under pressure: the limits for various implementing organisations have been reached in terms of capacity to meet the expectations of citizens, social

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[88] The 'cheese slicer method' leads to generic cuts spread across ministries and other government organisations, with no substantiated reduction of specific policy objectives. The wage and price adjustment is an allowance for increased taxes and thus an indexation necessary for the continuation of existing policy processes. Underspending does not only mean failure to spend the budgeted funds, but it also means that in the medium term, this previously planned expenditure will still go ahead, possibly at higher prices, in order to achieve the intended policy objectives.
[89] A first-order effect is the direct result of the proposal, in this case the direct savings anticipated. Second-order effects are the effects of the proposal on, for example, the economy and society. Third-order effects are the future consequences of the proposal.
[90] See the Advisory Division's opinions on the 2024 Tax Plan bill and on the Bill on Adjustment of Business Succession Tax Facilities 2024.

institutions, businesses and politicians.[91] The current tightness on the labour market exacerbates this problem.[92]

Moreover, plenty of alternatives are available: successive governments have at their disposal a large number of reports and studies with well-considered policy options and alternatives, which can help arrive at integrally considered efficient and effective choices and priorities. The Advisory Division understands the fact that these choices are not always easy and that the outcomes will not be appreciated by all stakeholders, but delaying choices exacerbates problems and makes the final choices more difficult.

The Advisory Division recommends that policy choices take sufficient account of the complexity of and connection between challenges, by integrally considering measures and identifying second and third-order effects and implementation consequences where possible. In this regard it is important that the final policy choices are simple, do not make systems more complicated and thus improve implementation. That is why (policy) evaluations, interdepartmental policy reviews (IBOs), in addition to studies and reports by assessment agencies and advisory councils, are important to be able to identify the best possible, i.e. also the broadest possible, substantiated (financial and other) options for action. Ensuring them to be of sufficient quantity and quality incidentally calls on not just the finance ministry but all ministries to promote them and act accordingly.

VI. *Create an orderly budgetary process by having one integral key decision-making moment in the spring that is aligned with the European Semester. Focus the August decision-making process exclusively on necessary adjustments and possible purchasing power measures.*

Since the revision of the budgetary process in 2022, the Spring Memorandum no longer just presents the changes in the current year's budget compared with the Budget Memorandum, but also the main points of the decisions related to the budget for the following year. It also outlines a multi-year scenario of expenditure and the main points associated with revenue.[93] As a result, the House is involved at an earlier stage in multi-year budgetary decision-making, improving its ability to exercise its parliamentary right associated with the budget, and a step is taken to better align the Dutch budgetary process with the European Semester.

An orderly budgetary process is in the interest of democracy, to provide insight into the impact of government policies on society, the economy and the budget. Clarity, predictability and calm in the budgetary process should be part of this. The Advisory Division found that in previous budgetary reports, the budgetary

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[91] Parliamentary Documents II 2021/22, 29361, No. 290.
[92] In its opinion on the draft 2023 Budget Memorandum, the Advisory Division recommended expanding the existing implementation analyses and tests on proposed policies by considering the labour market effects of proposed policies more explicitly.
[93] Parliamentary Documents II 2022/23. 36200, No. 6.

process appeared somewhat disorganised.[94] More calm can be achieved as a result of:

- A single integral main decision-making moment in the spring for the main lines of both the expenditure and tax side (including fiscal legislation) of the budget. This also benefits effective implementation in addition to improved integral consideration.
- A fixed moment for finalising decision-making in the spring and a fixed moment to publish the Spring Memorandum.
- Sending the budgetary documents supplementary to the Spring Memorandum to the House as a single package with the Spring Memorandum.
- An independent calculation of the policy intentions in the Spring Memorandum by the CPB.
- Limit decision-making in August to purchasing power measures (if needed).
- Align the budgetary process with the European Semester, which will change based on the outcome of the review of the European budgetary framework and which will focus on multi-year plans to be submitted by Member States to the European Commission (possibly as early as spring 2024) (see also Section E2). A timely Spring Memorandum as the main decision-making moment also serves this purpose.

VII. *Bring forward the introduction of the new financing system for local and regional authorities to when the new government takes office. Moreover, ensure that the level of finance for local and regional authorities is sufficient.*

In the 2023 Spring Memorandum, the government presented an outline of the new financing system for local and regional authorities as of 2026. From then on, the accrual system will be abandoned and an additional €1.1 billion will be structurally available (of which €1 billion for municipalities and €0.1 billion for provinces). From 2027, the municipal and provincial funds will be indexed based on the development of nominal GDP. This system is linked more closely to the broad expenditure development of local and regional authorities than the current accrual system. The growth trend of the funds will be based on a historical average of GDP development, which is expected to make the funds less volatile. Indexation for inflation follows that of the current year, keeping the funds on an appropriate level in real terms.

With a premature end to the current demissionary government term, the Advisory Division recommends bringing forward the introduction of the new financing system for local and regional authorities to when the new government takes office. At that time, clarity should also be provided on the scaling-up rebate, which has been removed up to 2025, but from 2026, appears as €675 millionin the budget. Needless to say, a new system that aims to achieve greater stability, calm and clarity for local and regional authorities' finances will only succeed in

[94] See, inter alia, the 2023 Spring Report and the opinion on the 2023 Budget Memorandum.

doing so if not only the system but also the budget level for local and regional authorities is sufficient. Only then will a better financial system also contribute to better intergovernmental relations.

2. Assessment under European fiscal rules

a. Relevant context

In its September Report, the Advisory Division assesses whether the public finances presented in the Budget Memorandum comply with European fiscal rules in the current year (in year) and in the year ahead (ex ante).

Current European fiscal rules

European fiscal rules are set out in the Stability and Growth Pact (SGP). One of the SGP's essential objectives, as part of the Economic and Monetary Union (EMU), is to guarantee the sustainability of public finances also in the longer term. Economic growth and convergence in the eurozone is the other essential objective.

The SGP consists of a corrective and a preventive arm. The rules of the corrective arm establish requirements for the (annual) maximum values for the budget deficit (EMU balance of no more than 3% of GDP) and government debt (EMU debt of no more than 60% of GDP). If the debt criterion is exceeded, the debt must be reduced by at least one-twentieth each year (debt reduction path). The purpose of the preventive arm is to prevent Member States from facing excessive deficits by having a safety margin in relation to the 3% deficit rule, so that Member States have budgetary scope to pursue countercyclical fiscal policies. If there comes a point when Member States fail to comply with the rules in the preventive arm, the basic principle is that Member States are subject to the corrective arm.[95]

The rules of the preventive arm consist of a medium-term objective (MTO), also known as the structural balance, and an expenditure rule. The structural balance is the budget balance adjusted for temporary measures and cyclical effects.[96] Member States have a country-specific MTO that applies to the structural balance. The expenditure rule within the preventive arm requires that government spending should not increase faster than potential economic growth, also taking into

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[95] In both the corrective and preventive arms, there are a number of exceptions to the requirements, also known as flexibilities. For an overview of these flexibilities, see pages 7 and 8 of Annex III of the Advisory Division's Guidance on the options for reforming the Stability and Growth Pact (W06.22.0005/III/Vo), Parliamentary Documents II 2021/22, 35925, No. 146.

[96] The structural balance is the actual budget deficit net of cyclical influences and incidental budgetary costs and benefits. The calculation of the structural balance requires, among other things, the value of the output gap. This means the calculation of the structural balance is partly dependent on unobservable factors. In practice, the balance, which needs to be calculated twice a year, is therefore volatile, resulting in regular retrospective non-compliance with the MTO if observations and realisations are added and changed.

account the distance to the MTO.[97] The idea behind the expenditure rule is that revenues move with the economic cycle and expenditure does not increase faster than potential economic growth, thereby preventing the structural balance from deteriorating.

The extraordinary years 2020-2024
In 2020, the European Commission activated the general escape clause of the SGP, affording Member States maximum flexibility within the SGP to make additional fiscal efforts following the Covid-19 crisis. Specifically, this means that Member States in the preventive arm of the SGP, including the Netherlands, may deviate from the path towards the medium-term objective for the structural balance (MTO) providing it does not jeopardise the sustainability of public finances in the medium term. The guidelines for the budgetary assessment in 2020-2023 are largely qualitative. However, the SGP's regular procedures have not been suspended. For instance, in the 2023 Spring Package, the Commission indicated that it will propose to the Council the possibility of establishing a deficit-based excessive deficit procedure in spring 2024, based on the budgetary results in 2023.[98] Therefore, it is still important that the development of public finances is monitored.

Flexibility within the SGP will end as of 2024, due to the deactivation of the general escape clause. At the same time, due to the ongoing uncertain economic situation and the ongoing review of the European budgetary framework, the Commission does not consider it appropriate to revert entirely to the usual fiscal rules as required under the current framework before 2024.[99] In other words, 2024 will be a transition year, so to speak.

Budgetary framework after 2024
For the years after 2024, the outcome of the review of the European budgetary framework, consisting of the Stability and Growth Pact (SGP), the European Semester and the Macroeconomic Imbalances Procedure (MIP), will be relevant. In November 2022, the European Commission published a communication on the possible structure of the future budgetary framework.[100] The initial Council

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[97] The expenditure rule, like the structural balance, is partly dependent on unobservable factors because the calculation requires, among other things, the value of the output gap. Nevertheless, in practice this rule is actually less volatile and therefore a more stable value than the structural balance.
[98] European Commission (2023). Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank. 2023 European Semester - Spring Package. COM(2023) 600 final.
[99] European Commission (2023). Communication on Guidance for fiscal policy for 2024, COM(2023) 141 final.
[100] European Commission (2022). Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions. Communication on orientations for a reform of the EU economic governance framework. COM(2022) 583 final.

conclusions, drafted by Member States, were published in March 2023.[101] The European Commission published its legislative proposals on this basis.[102] Currently, Member States are trying to reach an agreement with the European Commission on the new budgetary framework, after which trilogues between Member States, the European Parliament and the European Commission will begin in order to reach an agreement. National parliaments have a role in the process in the national implementation and execution of the revised framework and as co-legislators, so to speak.

At the request of the House of Representatives, the Advisory Division issued information on options for reforming the SGP.[103] The European Network of Independent fiscal Institutions, of which the Advisory Division and CPB are members for the Netherlands, also made recommendations.[104]

A medium-term focus, strengthening national ownership in the application of European fiscal rules, simplifying the framework and increasing compliance are key to the new budgetary framework to be established. Member States will in all likelihood have to draw up medium-term plans every four years, so-called 'medium-term fiscal-structural plans'. These fiscal plans must include the medium-term fiscal policy to be pursued as well as investments and reforms.[105] As several points are still under negotiation, it is not yet known how the final budgetary framework and process will be structured. Only then will it be possible to fully assess the implications for the Dutch budgetary process, cohesion with national fiscal rules and the impact on independent fiscal authorities.

Regardless of the exact outcome, the Advisory Division considers it important that the revised European budgetary framework enters into force on time and is clear (in quantitative terms) and enforceable. European independent fiscal authorities have previously expressed concerns about the lack of a clear and enforceable European budgetary framework for a number of years.[106]

One possible scenario is that the new European budgetary framework will enter into force as of 2025. This means that Member States must prepare and submit a

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[101] Council of the European Union (2023). Orientations for a reform of the EU economic governance framework – Revised Draft Council Conclusions. 14 March 2023 6995/2/23.
[102] Council Regulation (EC) No. 1466/97 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, Council Regulation (EC) No. 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure, and Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States.
[103] Parliamentary Documents II 2021/22, 35924, No. 146.
[104] Secretariat of the Network of EU IFIs (2023). EU Economic Governance Proposal Reform: Issues and Insights from EU IFIs.
[105] For a more detailed explanation of the assumptions for the future European budgetary framework, see the 2023 Spring Report
[106] Network of EU IFIs (2023). EU IFI Network Statement. The progress on the EU Economic Governance Reforms.

medium-term plan to the European Commission as early as spring 2024. Both the current demissionary government and a new government taking office in spring and the newly elected House of Representatives in November should bear this in mind and prepare for this scenario.

b. Assessment for 2023 and 2024

Assessment for 2023
With an estimated actual budget deficit of 1.5% of GDP and government debt of 47.7% of GDP, in 2023, the Dutch budget complies with the requirements of the corrective arm of the SGP of a maximum deficit of 3% of GDP and, respectively, maximum debt of 60% of GDP (see Table 6).

The outcome for the structural balance is a deficit of 1.6% of GDP for 2023. Thus, the projected outcome for the structural balance deviates from the medium-term objective (MTO) for the structural balance of -0.75% of GDP in 2023. Member States with a structural balance worse than the MTO must comply with the expenditure rule.[107] Based on calculations by the CPB for the Advisory Division's budgetary assessment, for the Dutch budget the expenditure rule implies permitted growth in adjusted public expenditure of up to 1.7% points in 2023. Estimated adjusted public expenditure is expected to increase by 0.73% points in 2023. This means the Netherlands will comply with the expenditure rule from the preventive arm of the SGP in 2023.

In 2023, the general escape clause of the SGP still applies, allowing the Netherlands to deviate from the path towards the medium-term objective for the structural balance (MTO) if this does not jeopardise the sustainability of public finances in the medium term. However, the general escape clause does not suspend the procedures of the SGP and it is important to monitor the medium-term sustainability of public finances (see Section E.2.c). A deficit-based excessive deficit procedure may be initiated in spring 2024, based on the budgetary results in 2023. Given the actual budget deficit of 1.5% of GDP in 2023, the Netherlands does not seem to be at risk before 2023.

Table 6: Figures for European fiscal rules 2022-2024

	2022	**2023**	**2024**
	ex post	*in year*	*ex ante*
Rule in relation to the development of the structural balance (% of GDP)			
Maximum actual EMU balance	*-3.0*	*-3.0*	*-3.0*
EMU balance (actual)	-0.1	-1.5	-2.4
Cyclical component	1.1	0.1	-0.2

[107] The expenditure rule within the preventive arm requires that government spending should not increase faster than potential economic growth, also taking into account the distance to the MTO. The idea behind the expenditure rule is that revenues move with the economic cycle and expenditure does not increase faster than potential economic growth, thereby preventing the structural balance from deteriorating.

One-off and other temporary measures	-0.2	0.0	0.0
Medium-term objective structural EMU balance	*-0.5*	*-0.75*	*-0.75*
Structural EMU balance (EC method)	-1.0	-1.6	-2.2
Expenditure rule			
Adjusted public expenditure (volume growth, %)*	1.1***	0.73	2.82
Standard growth (max. permitted growth corrected net public expenditure**)	*0.6****	*1.7*	*1.68*
Debt criterion (% of GDP)			
Maximum EMU debt	*60.0*	*60.0*	*60.0*
EMU debt	50.1	47.7	46.9

* Public expenditure, in accordance with European fiscal rules, has been corrected for interest expenditure, cyclical expenditure on unemployment benefits, expenditure on EU programmes funded by transfers from the EU and with a four-year average for public investment.

** Standard growth is the potential growth, corrected for the distance to the medium-term objective (MTO) for the structural EMU balance.

*** The figures for the expenditure rule in 2022 are the same as in the 2023 Spring Report.

Source: CPB (Macroeconomic Outlook 2024)

Assessment for 2024

With an estimated actual budget deficit of 2.4% of GDP and government debt of 46.9% of GDP, in 2024, the Dutch budget complies with the rules of the corrective arm of the SGP of a maximum deficit of 3% of GDP and, respectively, a maximum debt of 60% of GDP (see Table 6).

For the structural balance, the CPB expects a deficit of 2.2% of GDP in 2024. Thus, the projected outcome for the structural balance deviates significantly from the medium-term objective (MTO) for the structural balance of -0.75% of GDP in 2023. As the general escape clause will be deactivated as of 2024, Member States in the preventive arm of the SGP will no longer be allowed to deviate from the path towards the MTO for the structural balance from 2024 onwards. According to European fiscal rules, in this case an improvement in the structural balance of 0.5% of GDP per year is needed until the MTO, the target, is reached. If a Member State does not meet this benchmark, the expenditure rule for a Member State comes into play, in which the distance to the MTO is taken into account for the standard growth for net primary expenditure[108].

Based on the CPB's MEV forecast, no improvement of at least 0.5% of GDP is expected for the structural balance in 2024 compared with 2023. This makes assessment under the expenditure rule relevant when assessing compliance with the European fiscal rules for 2024. For the Dutch budget, the expenditure rule for 2024 implies maximum permitted growth in adjusted expenditure of 1.68%

[108] Net primary expenditure is defined as nationally financed expenditure net of discretionary measures on the revenue side and excluding interest expenditure and cyclical unemployment expenditure.

points. However, projected net government expenditure is higher than standard growth in 2024 and is expected to increase by 2.82% points. This means the Netherlands will not comply *ex ante* with the expenditure rule as part of the preventive arm of the SGP in 2024.

Table 7: Summary overview of the outcome of the assessment under European fiscal rules

	2022	2023	2024
Rules of the preventive arm:			
Structural EMU balance[(a)]	û	û	û
Expenditure rule	û	ü	û
Rules of the corrective arm:			
Actual budget balance	ü	ü	ü
Government debt	ü	ü	ü

Explanatory note on symbols used: ü = compliance with the relevant rule; ¡ = there is a deviation from the rule, but the deviation is not significant; û = there is a deviation from the rule, and calculated over one year and/or over two years, on average this deviation is significant (only applies to the structural balance and expenditure rule, see note)

(a) For the structural budget balance and the expenditure rule there is evidence of a 'significant' deviation if the deviation (in a negative sense), calculated over one year amounts to at least 0.5% points of GDP. There is also a significant deviation if there is a deviation of at least 0.5% points of GDP cumulatively over two years.

Conclusion

For 2023 and 2024, the Dutch budget is expected to meet the requirements from the SGP's corrective arm. However, for both years, there is no compliance with the rules for the structural balance, which implies expansionary fiscal policy. There will be compliance with the expenditure rule in 2023, but it is not expected in 2024. The government has previously stated, including in the Stability Programme 2023 and in the Coalition Agreement, that it has opted for expansionary fiscal policy. Expansionary fiscal policy spurs on the economy under a current tight labour market and high inflation. This does not support the current monetary policy of higher interest rates to curb inflation.[109]

If a cyclical downturn occurs and the government wants to provide scope for the automatic stabilisers to do their job, there is no margin within the limits of the European fiscal rules in 2023 and 2024 to be able to continue to implement trend-based fiscal policy. After 2024, the budget deficit and EMU debt are expected to increase (see Table 8 in the next section). Consequently, spending cuts or tax increases may prove inevitable in deteriorating economic times.

c. The sustainability of public finances

One of the essential goals of the SGP is to ensure the sustainability of public finances. For 2023, which is part of the budgetary assessment in this report, the general escape clause of the SGP is active. Under this clause, Member States may

[109] The European Fiscal Board (EFB) has advised Member States to adopt restrictive fiscal policy in 2024 to curb inflation. See: European Fiscal Board (2023). Assessment of the fiscal stance appropriate for the eurozone in 2024.

deviate from the path towards the MTO if this does not jeopardise the medium-term sustainability of public finances. In the review of the current budgetary framework, the Commission and the Council stressed that the sustainability of public finances should be an important aspect of a new framework.

The sustainability of public finances also plays a role in Dutch fiscal policy. Controlling public finances, by not passing on bills to future generations, is one of the three basic principles of Dutch fiscal policy. The medium and long-term sustainability of public finances is thus an important factor in the budgetary assessment. To this end, both financial sustainability (what outcomes for public debt are permissible) and intergenerational sustainability (distribution of financial burdens across generations) are important.[110]

In the 2023 Spring Report, the Advisory Division noted that the actual and structural balances for 2023 had deteriorated compared with the 2023 Budget Memorandum and that the CPB's multi-year forecast showed that the standard for the EMU balance of a maximum budget deficit of 3% of GDP would also be exceeded during the years in the forecast after this government term. This results in higher government debt in the medium term. Also, the European Commission's sustainability outlook for 2022 shows a deterioration in sustainability, while there was already a deficit.[111] Indeed, based on the so-called S2 indicator, which measures how much budgetary scope (in terms of the structural primary balance[112]) a Member State needs to stabilise government debt in the long term, the Netherlands is currently at a high sustainability risk.

In the 2023 Spring Report, the Advisory Division noted, based on the CPB's CEP forecast, that current government policies seem not only to impose budgetary constraints during this government's term, but that the standard for the EMU balance of a maximum budget deficit of 3% of GDP will also be exceeded in almost all years of the forecast after this government's term. This results in an increase in government debt in the medium term and a deterioration of the sustainability of public finances. The Advisory Division found that, if economic assumptions are the same, the next government will first have to reduce spending or increase taxes before any intensifications can be made.

In the draft Macroeconomic Outlook (August 2023), the CPB examined the development of the (structural) budget deficit and government debt up to 2028 (see Table 8). Compared to the previous CPB forecast (CEP), the forecast for the budget deficit and government debt between 2025 and 2028 will continue to

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110 CPB Netherlands Bureau for Economic Policy Analysis (2021). How do we measure whether public finances are sustainable? CPB Background paper, December 2021.
111 European Commission (2023) Debt Sustainability Monitor 2022.
112 The structural primary balance is the part of the structural balance determined by policy (i.e. minus interest charges). The S2 indicator consists of two elements, namely the initial fiscal position (gap between the initial structural primary balance and the debt-stabilising structural primary balance) and future costs related to an ageing population.

deteriorate. Therefore, the observation that the next government will first have to reduce spending or increase taxes before any intensifications can be made continues to be valid, even though the next government term will now start sooner.

Table 8: Development of the EMU balance and EMU debt 2025-2028

(in % of GDP)	**2025**	**2026**	**2027**	**2028**
Actual EMU balance	-2.6	-3.4	-3.3	-3.6
Structural EMU balance	-2.1	-2.9	-2.7	-3.0
EMU debt	48.3	50.1	51.8	53.0

Source: CPB Netherlands Bureau for Economic Policy Analysis (2023) Draft Macroeconomic Outlook 2024.

In the 2023 Spring Report, the Advisory Division advised the government to elaborate on the deterioration of the debt sustainability of the Netherlands in the 2024 Budget Memorandum, also in comparison with other European countries, due to the deterioration of debt sustainability in the European Commission's Sustainability Monitor.

In the 2024 Budget Memorandum, the government addresses the financial and intergenerational sustainability of public finances. The government does not consider the financial sustainability of public finances to be at stake, given the current level of the Netherlands' debt ratio and creditworthiness. To estimate the intergenerational sustainability of public finances, the Budget Memorandum includes a sustainability analysis by the CPB based on a DSA model. [113] The analysis shows that the increase in debt in the baseline is just above 60% of GDP in 2031. According to the CPB, there is a 50% chance that government debt will be between 53% of GDP and 68% of GDP and a 90% chance that government debt will remain below 77%.

The CPB produced new debt projections for the 17th Study Group on Fiscal Policy.[114] Based on the 2024 draft Macroeconomic Outlook, current policy intentions and the latest interest rate term structure, the projection of government debt in 2060 is 151% of GDP. This debt projection does not take into account uncertainty regarding government revenue and expenditure. The projection of the debt ratio in 2060 has increased compared to the Coalition Agreement analysis, mainly due to increased government interest.

With long-term interest rates of 1.5% and 4.5%, government debt would reach 127% of GDP and 211% of GDP in 2060, respectively. If healthcare expenditure increases by an additional 1% a year from 2032, government debt will be higher

[113] A Debt Sustainability Analysis (DSA) is an instrument used to assess a country's (long-term) debt sustainability and identify future risks.
[114] 17th Study Group on Fiscal Policy. (2023) Bijsturen met het oog op de toekomst. (Adjusting for the future.)

in 2060, ranging from 161% to 208% of GDP, depending on the extent to which the additional expenditure is financed by additional taxes for households.

The current estimate of the sustainability balance is -4.6% of GDP, based on the 2024 draft Macroeconomic Outlook. The sustainability balance reveals the extent to which tax increases will be needed before 2060 to continue financing existing public services and, provides a good indication of the extent to which financial burdens are put off to the future. The sustainability balance deteriorated by 0.3% of GDP compared to the analysis of the existing government's Coalition Agreement. This change is the result of a combination of new macroeconomic developments, amended policy, changes in the population forecast, some technical adjustments and updates in assumed growth in productivity and education, wage and care profiles.

The Advisory Division acknowledges the tension the government describes in the Spring Memorandum and the Budget Memorandum, among others, between investments made now for future challenges, such as between the climate transition and the long-term sustainability of public finances. Nevertheless, it remains relevant to keep an eye on the medium and long-term sustainability of public finances. The CPB's recent calculations for medium-term (2031) as well as long-term (2060) financial sustainability underline this relevance. Therefore, it is important to weigh up the allocation of resources in an integral manner in order to make well-considered choices. To enhance this integral consideration, the Advisory Division recommends incorporating the climate in the sustainability analyses (see also Sections D and E.1 of this report).

In the 2024 Budget Memorandum, the government does not discuss the deterioration in debt sustainability due to projected medium-term budget deficits, medium-term challenges in relation to debt sustainability, nor does it make a comparison with other European countries.

3. Assessment under national fiscal rules

3.1. Budgetary process

Since the revision of the budgetary process in 2022, the Spring Memorandum no longer just presents the changes in the current year's budget compared with the Budget Memorandum, but also the main points of the decisions related to the 2024 budget. In addition, it outlines a multi-year scenario of expenditure and the main points associated with revenue.[115]

By opting for a single, integral main decision-making moment in the spring for the main lines of both the expenditure and tax sides of the budget, various political wishes, problems and windfalls and setbacks can be weighed up in an integral manner. This creates stability and calm in political decision-making, by allowing integral considerations regarding different policy objectives to be performed at

[115] Parliamentary Documents II 2022/23. 36200, No. 6.

fixed times. It optimises compliance with the basic principles of Dutch fiscal policy, namely the efficient allocation of public resources, controlling public finances and contributing to economic stability.

In the 2023 Spring Report, the Advisory Division expressed its appreciation for the adjustments to the budgetary process already made by the government. At the same time, the Advisory Division noted that this year, like last year, there is no main decision-making moment and thus integral decision-making in the spring, partly because tax decisions for 2024 have largely been postponed to August. In Section E.1. of this report, the Advisory Division lists its recommendations for completing the new budgetary process.

3.2. Assessment for 2023 and 2024

In the Initial Policy Memorandum to the Coalition Agreement the government established its fiscal rules for this government term and confirmed its commitment to trend-based fiscal policy. On the expenditure side there are four multi-year expenditure frameworks (State Budget, Social Security, Healthcare and the new Investment Framework), with an annual expenditure ceiling that may not be exceeded.[116] However, the individual expenditure ceilings are indexed annually in relation to wage and price development. On the revenue side a revenue framework applies with automatic stabilisation: revenue windfalls benefit the government balance, revenue shortfalls burden the government balance. In this way, revenue moves in tandem, as it were, with the business cycle. In principle, the expenditure ceiling and revenue framework are not adjusted during the government term, which means that the frameworks set de facto policy-based upper limits for public finances.

In the frameworks revenue and expenditure are separate. This means that windfalls on the revenue side may not be used for additional expenditure, but also that revenue setbacks do not have to be offset by cuts on the expenditure side. Moreover, setbacks on the expenditure side must be compensated within the expenditure framework and must not lead to new measures on the revenue side. This provides maximum scope for automatic stabilisation and avoids pro-cyclical fiscal policy.

The Initial Policy Memorandum established the expenditure ceilings and revenue framework for this government term ex ante. The 2022 Spring Memorandum finalised them, also after incorporating the CPB's macroeconomic outlooks. In the same Spring Memorandum the government stated that the established revenue and expenditure frameworks serve as an anchor for this government term's budgetary policy.

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[116] For investments covered by the relevant expenditure ceiling, controlling the total amount is more relevant than the amount per year, and shifts over time are allowed, provided European fiscal rules allow for it.

The purpose of enforcing national fiscal rules is to ensure that public finances remain within the limits of what the government deems acceptable. The decision to establish the level of the revenue and expenditure frameworks at the beginning of a government term is a political choice. When establishing the national budgetary anchors for this government term, the frameworks did not comply with all European fiscal targets.[117] However, the arrangements agreed with regard to European fiscal targets are not optional. Therefore, non-compliance with European agreements could have consequences. The Advisory Division deems it important that if the performance of the Dutch budget does not comply with the European fiscal agreements, the government explains how it will move towards the applicable European targets.

The government states in the 2024 Budget Memorandum that it has retained the agreed financial frameworks as its starting point and does not want to pass on any costs. Therefore, the government argues that there is no margin for additional intensifications. The government does not consider this appropriate due to its demissionary status.

In the August decision-making process, a purchasing power package with structural measures applicable from 2024 was adopted with the aim of supporting vulnerable households and preventing a rise in poverty rates (see Section C for a more detailed explanation). In addition, a budgetary envelope has been allocated for erosion of the tax base in the area of mobility that may occur in the future as part of the climate challenge. Coverage is partly achieved by using a (policy) surplus in the revenue framework of €275 mln.

In addition, there is an indexation of the starting point in the top rate of Box 1 in income tax, both for employed persons and pensioners. Also, in the rates table for those born before 1 January 1946, the indexation of the starting point in the second bracket in Box 1 of income tax is limited. This brings it closer to the starting point for taxpayers born after 1 January 1946. It also increases alcohol excise duty and excise duty on tobacco. A surplus on the measures in the Spring Climate Package will also be used to cover the purchasing power package.

Table 9: Purchasing power package August decision 2023

(in million euros, - is balance deterioration)	**2023**	**2024**	**2025**	**2026**	**Struc.**
Purchasing power measures (cumulative)	-160	-2260	-2268	-2349	-2045
Coverage of purchasing power measures (cumulative)	0	2166	2187	2190	2287
Surplus spring climate package	0	0	68	118	352
Residual budgetary envelope erosion of the tax base	0	0	0	0	-271
Total purchasing power	**-160**	**-94**	**-113**	**-41**	**323**

Source: 2024 Budget Memorandum

[117] 2022 June Report, Parliamentary Documents II 36120, No. 3 W06.22.0084/111/B.

Purchasing power measures are included both on the expenditure side of the budget and the tax side. Coverage is provided entirely on the tax side. This means the government is not respecting the separation of revenue and expenditure.

No final decision about the revenue framework took place during the 2023 spring decision-making process, so the revenue framework was not closed and the final decision was needed in August. Given the demissionary status of the government, it was decided not to implement the three outstanding tax measures from the 2023 Spring climate package for the time being, but to leave the related decisions to the new government.

However, the government did take a measure to achieve additional CO2 reductions. For now, no additional funds will be allocated for this purpose. In the revenue framework, there were three outstanding coverage issues (lower revenue from Pillar 2 in corporate income tax, the tax constructions and tax schemes target, and the postponement of the new Box 3 system to 2027) that were provided with coverage in the August decision-making process.[118] The other tax-relevant measures were also integrated in the revenue framework and provided with coverage, and the tax measures from the spring were finally incorporated.

Cumulatively, the entire August decision-making (purchasing power and revenue framework) produces the following picture.

Table 10: Budgetary impact of taxes and purchasing power decisions August 2023

(in million euros, - is balance deterioration)	**2022**	**2023**	**2024**	**2025**	**2026**	**Struc.**
Total purchasing power decision	0	-160	-94	-113	-41	323
Revenue framework decision	-56	89	140	80	-250	96
Total August decision-making process	-56	-71	46	-33	-291	419

Source: 2024 Budget Memorandum

According to the government, the August decisions thus lead to structural balance savings of €419 mln after 2026. For 2023, the tasks are not fully covered: there is a deficit of €71 mln. For 2024, there is excess coverage of €46 mln.

On top of the August decisions, additional budget proposals have been incorporated in the draft budgets, all provided with coverage. For instance, the school meals programme has been extended for 2024, a scheme will be set up for single-income earners with an income below the income support level to compensate for negative effects due to the combination of tax, social security and benefits, and a number of measures in the field of agriculture will be covered by the Transition Fund. In addition, the government continues to allocate funds to

[118] It should be noted that coverage for Pillar 2, a measure for multinational companies with a turnover of more than €750 million, is not found in corporate income tax, but in the form of the increase in employer taxes, lowering the SME profit exemption for income tax entrepreneurs and increasing excise duties.

(the consequences of the war in) Ukraine. Spending on Ukraine falls outside the regular expenditure ceilings, as decided in 2022.

Budgetary decision-making is subject to the ceilings for expenditure and revenue agreed by this government until a new government takes office. Due to the demissionary status of the government, the CPB did not provide an overview and analysis of all ceiling adjustments and framework corrections in this August decision-making process.

The Advisory Division notes that it has not been able to conduct a full budgetary assessment this government term because information was missing or there was no orderly budgetary process. Because the Coalition Agreement had been outlined, the CPB published an analysis of the main lines of the fiscal and economic impact of the Coalition Agreement when the government took office. However, the CPB was not able to perform a full independent calculation of the Coalition Agreement because the details of many policy intentions were not available.

It was not until the 2022 Spring Memorandum, just under six months after the government took office, that the government set the expenditure ceilings and revenue framework for the government term. Since the government took office, the Advisory Division has only been able to assess the expenditure ceilings and revenue framework once based on independent fiscal information, namely in spring 2023. However, this was not based on the latest information at the time, as the spring decisions were not independently calculated by the CPB.

Independent forecasts and assessments with regard to compliance with national and European fiscal rules increase the transparency of choices, compel the government to improve fiscal policy and ensure better compliance with the agreed fiscal rules.[119] To produce independent assessments and forecasts, budgetary information must be sufficiently detailed and there must be an orderly budgetary process. This increases transparency for parliament and society about the policies pursued.

A new government will establish its own fiscal policy and budget system in an Initial Policy Memorandum. To this end, the Advisory Division provides some advice in Section E1. The Advisory Division considers it important for the next government to comply with its own agreed fiscal rules and arrangements, and for independent calculations of policy intentions and an assessment under national and European fiscal rules to be possible. This will create calm in the budgetary process, which promotes policy predictability and stable implementation.

4. Focal points related to the expenditure frameworks

[119] See, for example, IMF (2022) Reforming the EU budgetary framework: Strengthening the fiscal rules and institutions. International Monetary Fund, 5 September and European Stability Mechanism (2021). EU fiscal rules: reform considerations. Discussion Paper Series/17, October 2021.

4.1. Transparency

Transparent fiscal policy serves a democratic interest. It helps parliament arrive at an informed opinion on government policy and helps create public support for policy. Therefore, the Advisory Division reflects on the degree of transparency of fiscal policy in its budgetary reports.

Transparency of budgetary information

The Advisory Division noted in the 2023 Spring Report that the government has followed previous advice issued by the Advisory Division to, for example, make the multi-year horizontal (year-on-year) development of expenditure and taxes transparent, but that improvements can also be made to increase the transparency of budgetary documents. For instance, it lacked an integrated overview of the total coverage challenge, intensifications and spending cuts.

Because coverage in the 2023 Spring Memorandum was achieved using a variety of items in departmental budgets and the explanations were generally technical in nature, the decision-making incorporated in the Spring Memorandum was difficult to follow and grasp. Moreover, there were significant differences between the outcome of the CPB's CEP forecast, on the basis of which the Stability Programme was drawn up, and the incorporation of the spring decisions in the Spring Memorandum. The reason for these differences was not subsequently explained in the Spring Memorandum.

In its response to the 2023 Spring Report, the government stated that due to the multiplicity of tasks, the Spring Memorandum contains more information than usual and is spread across multiple topics. In response, the government promised to include a complete vertical overview of the coverage challenge and possible intensifications and spending cuts in the Budget Memorandum.

When answering parliamentary questions on the 2023 Spring Memorandum, the changes in the Spring Memorandum compared with the 2023 Budget Memorandum were clarified, in response to the Advisory Division's opinion in the 2023 Spring Report.[120] The 2024 Budget Memorandum contains a ceiling test with corresponding sub-ceiling tests and vertical explanations. Annex 17 to the Budget Memorandum contains a vertical explanation per budget chapter showing the budgetary changes that have occurred since the 2023 Spring Memorandum. The government intends to continue this approach in the 2024 Spring Memorandum.

In addition, in the 2024 Budget Memorandum the government included an overview of the differences in the forecasts with the CPB. There are differences in methods for both assumptions and forecasts. For instance, the CPB estimates higher levels of underspending than the government on, for example, education, defence and infrastructure, the CPB expects lower revenues over the entire forecast period than the government and the CPB assumes a number of items to

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[120] Parliamentary Documents II 2022/23, 36350, No. 2.

be structural, while the government estimates them to be incidental. In addition, the government uses a different forecast method for the EMU balance of local and regional authorities than the CPB, resulting in a difference in the balance. In the short term, this leads to a more negative estimate of the EMU balance by the government than the CPB; in the long term, it leads to a more positive estimate of the EMU balance by the government than the CPB.

The Advisory Division notes that the government has taken new steps in improving the transparency of budgetary information. Thus, in addition to the previous actions to increase transparency such as insight into the horizontal development of tax and expenditure, the Budget Memorandum includes an overview of the differences between the outcomes of the CPB forecasts and the government's estimates. The Advisory Division considers that the overview provides insight into the significant differences in the methods used for the assumptions and forecasts by the CPB and the government. This insight increases the transparency of budgetary information. Therefore, the Advisory Division deems it important to continue to highlight the differences between the independent CPB forecasts, on which the Advisory Division relies in its role as independent budgetary monitoring institute, and the government, in future budgetary documents. The Advisory Division also considers it desirable to reduce differences in the forecast methods used by the CPB and the government, insofar as possible.

The vertical explanations of the sub-ceilings in the 2024 Budget Memorandum and the vertical explanations for each budget chapter in the annexes to the Budget Memorandum provide detailed and at the same time clear insights into the changes in the various ceilings and budgets. This concerns policy changes as well as, for example, the movement of funds, windfalls and setbacks.

Budgetary funds
The Fourth Rutte cabinet announced two new budgetary funds: the Climate Fund and the Transition Fund for Rural Areas and Nature. Budgetary funds are established by law and have their own chapter in the state budget.[121] The bills to establish the Climate Fund and the Transition Fund are currently before the Senate for consideration.[122] The budgetary funds have not yet been established; neither have chapters been added to the state budget. Expenditure in the area of future budgetary funds is currently financed from the departmental budgets of the Ministry of Economic Affairs and Climate Policy (EZK) and the Ministry of Agriculture, Nature and Food Quality (LNV), respectively.

The Advisory Division considers it important to make it clear in the Budget Memorandum and in departmental budgets that the Climate Fund and the Transition Fund do not yet exist in budgetary-legal terms, and that expenditure to be charged to the funds to be established in the 2024 state budget will be

[121] Articles 2.1 and 2.11 of the Government Accounts Act (CW) 2016.
[122] Parliamentary Documents II, 2022/23, Nos. 36274 and 36277.

processed in departmental budgets. Making this explicit ensures transparent fiscal policy and reinforces the implementation of parliamentary rights associated with the budget.

4.2. Quality of public finances

High quality public finances are essential for the effective and efficient deployment of public resources. Article 3.1 of the Government Accounts Act (CW) requires an explanation of the proposals, intentions and commitments of (1) the pursuit of the objectives, effectiveness and efficiency, (2) the use of the policy instruments and (3) the financial consequences for the State and, where possible, for the social sectors. The new working method for Article 3.1 of the Government Accounts Act (CW), implemented in 2021, should ensure better ex ante justification of policies.[123]

The Government Accounts Act (CW) 3.1 requirements are part of the government-wide evaluation system, which provides information on the effectiveness and efficiency of policy. Central government has at its disposal an extensive evaluation system at various stages of policy and legislation. This means relevant reports are available at various decision-making moments, such as when a new government takes office, the Spring Memorandum and the Budget Memorandum, which can help in making efficient and effective choices.

In the 2023 Spring Report, the Advisory Division noted that the government was deploying unmotivated and unfocused expenditure cuts for coverage, while the government has at its disposal a large number of reports and studies with well-considered policy options and alternatives, which can help to arrive at integrally considered choices and priorities.

The Advisory Division considers it positive that the purchasing power package in the 2024 Budget Memorandum is covered by policy choices, which are provided with an explanation. The Advisory Division encourages the next government to continue to focus on proper justification of policy measures, taking into account implementation consequences and second and third-order effects. This benefits the quality of public finances (see also Section E1).

In the 2024 Budget Memorandum, the government included a historical reflection on underspending over the past 15 years. The overview shows that underspending has increased from an average of 1% of the budget between 2008 and 2015 to over 2.5% in 2021 and almost 3.5% in 2022. In euros, underspending amounted to €6 bln in 2022. Thus, in recent years, underspending has increased in absolute and relative terms.

As far as structural expenditure is concerned, the government generally considers it complicated to assess whether underspending is incidental or structural in

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[123] Parliamentary Documents II 2021/22, 31865, No. 198.

nature. If underspending occurs, the government assumes that funds will be spent in the medium term, unless a decision is taken to reduce the budget.
The government expects continued substantial incidental underspending in the coming years, due to the tight labour market. The government takes this into account in the forecasts, by including the expected additional underspend in the supplementary budget item in addition to the regular year-end margin.

The funds can then be used for other priorities. Additional underspending was included for the first time in the 2019 Budget Memorandum, since then the instrument has been used five more times. If the underspend is lower, this results in an overshoot of the expenditure ceiling and a deterioration of the EMU balance. Therefore, it is important to estimate underspending realistically. The use of the instrument of supplementary underspending and its advantages and disadvantages will be evaluated by the 17th Study Group on Fiscal Policy in its policy review this autumn.

The Advisory Division stresses that using underspending for other priorities does not, on balance, create scope in the budget, as the policy objectives must be achieved at a later date. If, nevertheless, underspending is used for coverage purposes, this must be accompanied by a downward revision of policy objectives. The Advisory Division considers it positive that the government has further analysed underspending and recommends continuing to investigate the causes of underspending, in order to improve the quality of public finances.

5. Focal points related to the tax framework

5.1. Climate

Given the demissionary status of the government, it was decided not to implement the three outstanding tax measures from the 2023 Spring Climate Package for the time being, but to leave the related decisions to the new government. The 2023 Spring Climate Package included decisions amounting to almost €28 billion in expenditure and €1.8 billion in revenue between 2023 and 2030.[124] The 2023 Spring Climate Package was not incorporated in the 2023 Spring Memorandum. Moreover, at that time, no integral decision-making took place on, among other things, the policy mix for the climate, i.e. the division between subsidies, standardisation and pricing, because measures on the tax side had been postponed to the August decision-making process.

The 2024 Tax Plan Bill includes scaling back the reduced motor vehicle tax rates for camper vans. The explanatory memorandum to the bill indicates that, compared to passenger cars, camper vans emit relatively more CO2, nitrogen oxide and particulate matter and thus contribute substantially to total emissions from road traffic. However, the explanatory memorandum does not make clear why the proposed scale back, namely half the rate instead of a quarter of the rate,

[124] Annex 1 to the 2023 Spring Climate Package. Parliamentary Documents II 2022/23, 32813, No. 1230.

would then be balanced in the context of climate policy. Commercially rented camper vans are already subject to half the rate, so the measure will not create an environmental tax incentive for this group.

In the explanatory memorandum the Advisory Division is missing a consideration and prioritisation of the purpose of half the rate for camper vans and climate policy objectives. This also applies to maintaining the exemption in motor vehicle tax for motor vehicles built before 1988 (classic car scheme) and the increase in the travel allowance.[125]

The Advisory Division considers it important to make decision-making on climate measures part of integral considerations and thus of the main decision-making moment in the spring (see also Section D). This promotes a good mix of policy instruments and thus the efficiency and effectiveness of climate policy.

5.2. Tax structures and tax schemes target

No final decision about the revenue framework took place during the 2023 spring decision-making process, so the revenue framework was not closed and the final decision was needed in August. In the revenue framework there were three outstanding coverage issues from the spring, including the tax constructions and tax schemes target, which were provided with coverage in the August decision-making process.

In the 2023 Spring Report, the Advisory Division noted that in the spring, the government decided that, if the target to tackle tax constructions and tax schemes cannot be fully achieved, the remaining coverage challenge would be achieved by increasing the rate in the first bracket of Box 1 of income tax. The Advisory Division considered this compensation noteworthy because part of the objective of the target is to reduce wealth inequality and favourable tax arrangements for specific groups and companies. However, as far as natural persons are concerned, they generally pay Box 2 tax and not Box 1 tax. However, the Box 2 rate has not been changed.

The 2024 Budget Memorandum shows that the first tax bracket in Box 1 of income tax will indeed be increased, as the tax constructions and tax schemes target will not be achieved. This means that taxpayers who generally do not benefit from those very constructions and favourable arrangements must provide cover for them. The Advisory Division notes the lack of a rationale for the choice of placeholder and recommends that the current and future choices for placeholders be provided with a rationale to make the considerations transparent.

F. RESPONSE FROM THE DEMISSIONARY GOVERNMENT

<u>*Introduction*</u>

[125] See also the Advisory Division's opinion on the 2024 Tax Plan.

The government thanks the Advisory Division of the Council of State (hereafter referred to as: the Advisory Division) for its assessment on the development of public finances and the extent to which this development complies with the rules of the Stability and Growth Pact (SGP). The Advisory Division provides several valuable pieces of advice for future fiscal policy in this September Report. Because of the government's demissionary status, it is up to the next government to consider them. The recommendations will be passed on to the 17th Study Group for Fiscal Policy.
This government response, in addition to the other recommendations issued by the Advisory Division, addresses the advice on (i) budgetary anchors and budgetary scope, (ii) the budgetary process, (iii) the quality of public finances and (iv) local and regional authorities. The advice on the climate and broad prosperity are discussed in detail in a further report, which was sent to parliament at the same time as the 2024 Budget Memorandum.

E-1 Advice for future fiscal policy

i) Budgetary anchors and budgetary scope

The Advisory Division stresses the importance of monitoring the medium and long-term sustainability of public finances. In doing so, the Advisory Division notes that in the 2024 Budget Memorandum, the government does not address the deterioration due to projected medium-term budget deficits, medium-term challenges in relation to debt sustainability. There is also no comparison with other European countries. In addition, the Advisory Division recommends incorporating climate in the sustainability analyses. Moreover, the Advisory Division advises the next government to choose a budgetary anchor that ensures sufficient budgetary scope. This would enable automatic stabilisers to do their job and there would be no need to make sudden spending cuts when faced with economic downturns. The Advisory Division also mentions that if policy remains unchanged, the budget is expansionary, and therefore prudent fiscal policy should be pursued during the coming government term.

The government endorses the importance of monitoring medium and long-term sustainability.

Given the importance of sound public finances, the government provided budgetary coverage for the measures in spring and this August. The Budget Memorandum addresses, in qualitative terms, risks arising from an ageing population and climate change. A Debt Sustainability Analysis is also included. This provides insight into the potential debt development in the medium term. The Budget Memorandum also includes a section on public finances in the eurozone, reflecting on developments in the debt and balance of eurozone countries. The government endorses the potential impact of climate on sustainability. The further report elaborates on this.

The government endorses the importance of ensuring the proper functioning of automatic stabilisers and avoiding sudden, drastic spending cuts. It is up to a subsequent government, partly based on the recommendations of the 17th Study Group on Fiscal Policy, to shape fiscal policy and decide on the budgetary anchor and budgetary scope.

ii) Budgetary process

The Advisory Division stresses the importance of an orderly budgetary process, with clarity, predictability and calm. This also serves a democratic interest, to provide insight into how government policy affects society, the economy and the budget. The Advisory Division writes that it has already noted in previous budgetary reports that the budgetary process looks disorganised and offers some advice on how to create more calm. Besides a single main decision-making moment, the Advisory Division also recommends choosing a fixed moment in the spring for finalising decision-making and publishing the Spring Memorandum. In addition, it is advisable to send the budgetary documents as a single package in addition to the Spring Memorandum. The Advisory Division also recommends an independent calculation of the policy intentions in the Spring Memorandum by the CPB, limiting August decision-making to purchasing power measures and aligning the budgetary process with the European Semester.

The government acknowledges that the Advisory Division sees that the multi-year Spring Memorandum involves the House of Representatives earlier in decision-making, promotes implementation of parliament's rights associated with the budget and a step has been taken to align the Dutch budgetary process more effectively with the European Semester. The demissionary government endorses the importance of a fixed moment for finalisation and publication in the spring, sending a package of budgetary documents and improved alignment with the European Semester. Until now, the deadline for the Stability Programme (1 May) meant it was not possible to incorporate spring decision-making. It is currently being examined how this can be organised under the revamped Stability and Growth Pact. Given its demissionary status, it is up to the next government to take further steps on adjusting the budgetary process, both nationally and in terms of alignment with Brussels.

iii) Financing system for local and regional authorities

The Advisory Division recommends bringing forward the introduction of the new financing system for local and regional authorities to when the new government takes office, to offer clarity about the scaling-up rebate. It also stresses that the system only contributes to better financial relations if the budget available is sufficient.

The government feels supported in the move to the new funding system by the Advisory Division's positive appreciation in the 2023 Spring Report. This step creates the desired stability with regard to funding for local and regional authorities The possible early introduction of this system has budgetary implications and is up to the next government. A relevant focal point is the agreement with the Association of Netherlands Municipalities (VNG) that the volume part of the accrual will be frozen at the level in the 2022 Spring Memorandum until 2025. The government is convinced that local and regional authorities are offered a stable, solid and sustainable basis. The balance between ambitions, tasks, resources and implementation power is an ongoing topic of discussion.

iv) Quality of public finances

The Advisory Division stresses that the quality of public finances is important for achieving societal goals. Therefore, the Advisory Division recommends that when substantiating and making policy choices, sufficient account must be taken of the complexity of and connection between challenges, by integrally considering measures and identifying second and third-order effects and the consequences of implementation where possible. The Advisory Division notes that the reduction measures list and the corresponding tax measures list, do not take this sufficiently into account.

The government shares the Advisory Division's view that looking at policies in a coherent manner is of great importance. Recognising and weighing up this connection improves policy and contributes to the transparency of the democratic process. At the same time, when analysing policies and policy areas, it is necessary to do so in-depth. Therefore, the government endorses the extremely useful added value of policy evaluation instruments such as Interdepartmental Policy Reviews (IBOs) and Broad-based Social Reconsiderations (BMHs). These types of studies are ideally suited to consider measures in conjunction.

The reduction measures list and tax measures list are intended as an official independent overview of policy options. Aspects involved in the implementation are taken into account wherever possible. The introduction to the reduction measures list includes a disclaimer stating that if parties wish to opt for a particular measure, the consequences of its implementation should be subject to further assessment. In addition, it is mentioned that measures cannot simply be added up, given the overlap or exclusion of several measures. The announced update of the reduction measures list will also explicitly consider which policy options make it easier for citizens and/or implementation. To the extent known, second-order effects will also be pointed out.

E-2 Assessment under European fiscal rules

The Advisory Division considers it important that the Revised European Budgetary Framework enters into force on time and is clear and enforceable. In the September Report, the Advisory Division assesses the budget's compliance with European fiscal rules in 2023 and 2024. The CPB's Macroeconomic Outlook serves as the basis for this assessment. The Advisory Division concludes that the government complies with the rules of the corrective arm of the Stability and

Growth Pact in 2023 and 2024, but not the rules of the preventive arm. According to the CPB, the EMU balance will be -1.45% in 2023 and -2.15% in 2024. This is below the European threshold value of 3%. EMU debt is also lower than the 60% target, according to the CPB: in 2023, it is 47.7% and in 2024, 46.9%. The Netherlands does not comply with the rules of the preventive arm. Currently, the Netherlands has a medium-term objective (MTO) for the structural balance of -0.75% of GDP. According to the CPB, the structural balance is -1.48% of GDP in 2023 and -2.15% of GDP in 2024.

The government endorses the Advisory Division's assessment on compliance with European fiscal rules. The government acknowledges that the budget is at odds with the preventive arm of the SGP. This stems from the government's choice in the Coalition Agreement for an ambitious investment agenda, with investments in important and necessary societal challenges, including the climate, education and the housing market. The government considers this necessary to avoid higher costs and a loss of broad prosperity in the future. This results in a deterioration of public finances. Therefore, the government has opted to provide coverage for setbacks this spring on interest expenditure and asylum costs. Budgetary coverage is also provided for the purchasing power package.

The government also recognises the importance of timely implementation of the revised European budgetary framework with clear frameworks. Ensuring clarity and effective enforcement in the European budgetary framework is key to promoting sound and stable finances within EMU. This spring, the government set out its commitment to the new SGP to parliament in the document *'Regulations and directive on the revision of the European budgetary framework'*.

E-3 Assessment under national fiscal rules

The Advisory Division concludes that this year, like last year, there is once again no main decision-making moment and thus integral decision-making in the spring, partly because tax decisions for 2024 have largely been postponed to August. According to the Advisory Division, a single, integral main decision-making moment can ensure integral consideration and thus stability and calm in political decision-making. This benefits fiscal policy. In addition, the Advisory Division notes that it has not been able to conduct a full budgetary assessment this government term because information was missing or there was no orderly budgetary process. In spring 2023, the Advisory Division was able to perform an assessment, but this, it said, was not based on recent information because the spring decisions were not independently calculated by the CPB. Lastly, the Advisory Division concludes that it is important for a (next) government to comply with its own rules and agreements.

The government endorses the importance of an orderly budgetary process and its contribution to calm and stability and political decision-making. At the same time, in line with the response to the 2023 Spring Report, the government argues that a main decision-making moment in the spring, which also fully includes taxes, has both advantages and disadvantages. Nonetheless, it is still important to have the opportunity in August to look at purchasing power trends based on the latest economic figures. In practice, it is considered desirable for the entire revenue decision-making process to take place in August, as was the case with previous governments. Conducting the entire tax decision-making process in August also offers advantages, as it would otherwise require decision-making on the same issue twice. As usual, the Study Group on Fiscal Policy will also review the budgetary process. Based on that opinion, a subsequent government will decide accordingly.

E-4 Focal points related to the expenditure frameworks

The Advisory Division stresses the importance of transparency in fiscal policy and the introduction of new budgetary funds in the Dutch government budget. The importance of transparency in fiscal policy is stressed, with the aim of enabling parliament to make informed decisions and creating public support. In doing so, the Advisory Division notes that new steps have been taken in improving the transparency of budgetary information. Compared to the Spring Memorandum, the Advisory Division finds the main adjustments to the budget via the ceiling tests combined with the vertical explanations for each budget insightful. Furthermore, the Advisory Division considers it important to make it clear in the Budget Memorandum and in departmental budgets that the Climate Fund and the Transition Fund do not yet exist in budgetary-legal terms, and that expenditure to be charged to the funds to be established in the 2024 state budget will be processed in departmental budgets. The Advisory Division considers it positive that the purchasing power package in the 2024 Budget Memorandum is covered by policy choices, which are provided with an explanation. The Advisory Division stresses that using underspending for other priorities does not, on balance, create scope in the budget, as the policy objectives must be achieved at a later date. If, nevertheless, underspending is used for coverage purposes, this must be accompanied by a downward revision of policy objectives. The Advisory Division considers it positive that the government has further analysed underspending and recommends continuing to investigate the causes of underspending, in order to improve the quality of public finances.

The government acknowledges that the Advisory Division sees that steps have been taken to make the budget more transparent. Transparency is essential for parliament to exercise its rights associated with the budget. The government will also take up further recommendations to continue to improve transparency. This remains a learning process. It is also true that the Climate Fund and the Transition Fund do not yet exist in budgetary-legal terms. Efforts have been made to make the relevant expenditure as transparent as possible on the relevant budgets for this interim period and thus also optimally promote the implementation of parliament's rights associated with the budget.

The government endorses the conclusion that, on balance, underspending does not always lead to greater scope within the budget. Some of the unspent funds are spent later, burdening the balance. The government has devoted considerable attention to underspending in the 2022 Annual Financial Report of the Kingdom and the 2024 Budget Memorandum. The government takes the Advisory Division's advice to continue monitoring the causes of underspending seriously.

E-5 Focal points related to the tax framework

In its report, the Advisory Division indicates that there has been no integral decision-making on the climate this year, as measures on the tax side in the spring were postponed to August. The Advisory Division considers it important that this does happen, in order to perform an integral consideration of the policy mix. This promotes a good mix of policy instruments and thus also the efficiency and effectiveness of climate policy. The Advisory Division indicates that there is a lack of motivation for choosing the placeholder. The Advisory Division notes that the government has chosen to increase the first bracket of Box 1 income tax. The government established this as a provisionally chosen measure (placeholder) in the Spring Memorandum if it failed to fully meet the target to tackle tax constructions and tax schemes. The Advisory Division advises the government to substantiate current and future choices for placeholders in order to make considerations transparent.

The government acknowledges that ideally both tax and expenditure measures related to the climate should be decided in the spring. However, the government has chosen to deviate from this for a number of measures. The main reason for this was that it appeared the effects had not yet been sufficiently mapped out to allow for prudent decision-making. Independent studies have therefore been launched both with regard to energy taxation and tax schemes with a possible link to fossil emissions. These were delivered in the summer. Consequently, the government did define decisions in principle and/or a target in the spring as part of integral considerations. As for the exact details, the government felt it was wise to wait for the results of the studies, and include this in the August decision-making process.

During last year's August decision-making process, it was decided to include a rate increase in the first bracket of Box 1 as a placeholder for the inefficient tax schemes and constructions target. This year, in line with the decision last year, this placeholder has been deployed as necessary. The government recognises that the substantive relationship between the target and the placeholder is not very direct. For the use of placeholders, a specific parameter needs to be designated to give credibility to a target's budgetary importance. In a general sense, often, a placeholder will not be totally consistent with the target group of the target formulated. For the inefficient tax schemes and constructions target, for example, these occur in different areas of the tax system. Within this context, the government takes the recommendation seriously to provide placeholders with more effective substantiation.

Yours sincerely,

the Minister of Finance,

Sigrid A.M. Kaag

The response from the government has not prompted the Advisory Division to change its assessment.

The Vice-President of the Council of State,