Raad van State

To the Minister of Finance

No.W06.20.0106/III 's-Gravenhage, 15 April 2020

Dear Mr Hoekstra,

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. It is the task of the independent fiscal monitoring institute to draw up an assessment of whether European fiscal rules are being met.

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 economic and budgetary forecasts and analyses are assigned to the CPB. The Advisory Division has been charged with the more normative assessment of compliance with (European) fiscal rules.

The Advisory Division generally publishes two reports a year, in April and September. In the reports it provides an assessment of the expected budgetary developments and intentions as adopted by the government in the Stability Programme and Budget Memorandum, respectively. In the current circumstances the Advisory Division does not consider it worthwhile to compile a standard report. The assessment of the Stability Programme is usually based on the forecasts presented in the Central Economic Plan (CEP). However, this year it has not yet been possible for the forecasts to take into account the rapidly changing economic situation resulting from the measures adopted to manage the COVID-19 outbreak.

The European Commission deems the continuity and coordination of budgetary policy to be of undiminished importance. Therefore, it has decided to continue the semester under the current circumstances. Furthermore, Member States are required to provide streamlined reporting, which contains a qualitative description of the emergency measures and where possible, an estimate of the related budgetary impact.[1]

On 9 April, the government adopted the Stability Programme 2020, in which the existing format of the Stability Programme is applied rather than an adapted format. Therefore, the Stability Programme established by the government

[1] European Commission, Guidelines for a streamlined format of the 2020 Stability and Convergence Programmes in light of the COVID-19 outbreak. (Note for the Alternates of the Economic and Financial Committee) 6 April 2020.

currently contains, for example, the usual sustainability analysis and a detailed forecast based on the CEP of 3 March. However, as mentioned above, the effects of the COVID-19 crisis have hardly been taken into account as yet in this forecast. Nevertheless, it addresses all aspects the Commission requires of Member States: an outline of the economic situation, the measures taken, and a limited forecast for 2020 and 2021. Where necessary the government refers to the CPB's scenario-analysis in the Stability Programme.[2]

For 2019 it is clear that the debt ratio (48.6% of gross domestic product (GDP) and the actual balance (1.7% of GDP)) easily satisfies European targets (maximum debt of 60% of GDP and maximum deficit of 3% of GDP).[3]

It is not yet possible to provide an assessment of compliance with European fiscal rules (as valid up until the COVID-19 pandemic) for the current year and next year. This is due to the uncertainties that surround the Stability Programme caused by the COVID-19crisis. It is unclear how long contact restrictions and support measures will continue. The resulting economic effects also remain uncertain. Since these uncertainties are more extensive than usual, it is not possible to provide a usual assessment of the effect on the balance and debt of the Dutch government for the current and next year.

Scenarios are an effective means of providing indicators of the order of magnitude of the economic effects of the COVID-19 crisis, which assume varying degrees of the level of contamination. They are also useful in identifying important mechanisms and uncertainties behind these effects.

According to all four CPB scenarios a recession is to be expected despite an extensive package of emergency measures. In 2020, GDP will contract by 1.2% to 7.7%. In the most optimistic scenario the economy will already pick up in the third quarter of 2020. In the worst case scenario there will also be problems in the financial sector and the picture abroad will deteriorate further. In that scenario GDP will also contract by 2.7% in 2021.

In three of the four scenarios the downturn is more severe than in the 2008/2009 crisis. In these scenarios the budget deficit amounts to between 4.6% and 7.3% in 2020. According to the most pessimistic scenario the economy will not recover next year, unemployment will grow to 9.4% and government debt to 74% of GDP.[4] The CPB emphasises that it is also possible that the economic reality will be even worse than presented in the most pessimistic scenario.

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[2] CPB (2020), Scenario's economische gevolgen coronacrisis (Scenarios for the economic impact of the Coronavirus crisis (26 March 2020) https://www.cpb.nl/scenarios-coronacrisis.

[3] CBS, actual figures 2019.

[4] The CPB figures do not include a forecast of the structural balance, because it cannot be calculated due to the many uncertainties.

The European Commission has activated the general escape clause in the Stability and Growth Pact.[5] The general escape clause allows Member States in the preventive arm (such as the Netherlands) to deviate from the path towards the medium-term objective (MTO), providing it does not jeopardise sustainability in the medium term.[6] Therefore, the fact that the effects of emergency measures on the budget are not taken into account in the assessment of compliance with European rules, is clear.

The effects of the crisis go further than those of emergency measures, because revenue will also be below earlier forecasts due to the economic contraction. The government's extra financing requirements for the next three months are estimated at between €45 and €65 billion (5 to 8% of GDP). This is the sum of emergency measures, automatic stabilisers and deferred taxes; the extent to which these will still be collected is uncertain.

Since 2016, the Netherlands' budgetary policy has shown a surplus. This means that government debt fell to 48.6% of GDP. Consequently, this created some room for manoeuvre below the European budgetary reference value of 60%, which can be used in this exceptional situation. The effect on sustainability in the medium term, the condition in the general escape clause, has not yet been assessed by the government.[7]

The CPB has analysed the sustainability of the Dutch government's finances (before the pandemic). With the continuous care arrangements the sustainability gap 'before the COVID-19 crisis' has been calculated at 0.8% of GDP. The calculation of the sustainability gap depends to a large extent on assumptions about the growth of productivity and the supply of labour in the future. Half a percent higher growth a year means an increase in earning capacity of 20% of GDP in forty years. Therefore, it is vital that at some point an estimate is produced of the impact of the COVID-19crisis on, respectively, productivity, labour supply, the economy and thus sustainability. It is too soon to do so now.

Therefore, the Advisory Division advises the government to also present this issue to the Study Group on the Budget Margin (Studiegroep Begrotingsruimte). This would enable the government to provide insight into the medium-term sustainability in the Budget Memorandum, in accordance with the conditionality of the activated general escape clause.

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5 European Commission, Communication from the Commission to the Council on the activation of the general escape clause of the Stability and Growth Pact. COM (2020) 123 final, 20 March 2020.

6 Regulation 1466/97 Articles 5(1), 6(3), 9(1) and 10(3) and Regulation 1467/97 Articles 3(5) and 5(2).

7 CPB (2019) Zorgen om morgen (Concerns for tomorrow), sections 3.4 and 5.6. and the update in the Central Economic Plan 2020.

All in all, the Advisory Division establishes that in the Stability Programme the government has complied with the European Commission's request for Member States to provide as much insight as possible into:
a. The adopted and proposed measures in relation to the COVID-19crisis and
b. The associated economic effects.
The States General of the Netherlands have agreed on these measures.[8]

The Advisory Division is of the opinion that, given the current crisis situation and in line with the recommendations of the European Commission, it is prudent that the government plays an active role and that it has taken emergency measures. At the moment it is difficult to effectively assess the consequences for the budget, as stated above. The Advisory Division considers it desirable for the government to provide an insight into how it will ensure government finances continue to be sustainable in the medium term, at the latest in the Budget Memorandum. This condition is also included in the general escape clause. The Advisory Division recommends this also be situated in the context of the coordinated strategy to be published by the European Commission in the autumn to help 'restart' the European economy after the crisis.

Given the extraordinary circumstances it has been agreed with you that the usual administrative *audi alteram partem* procedure be omitted with regard to the assessment of this Stability Programme. The Advisory Division intends to issue a more detailed assessment on the occasion of the submission of the draft Budget Memorandum and draft State Budget in September, based on the forecasts of the CPB.

The Advisory Division requests that you forward copies of this letter to both chambers of the States General.

The Vice-President of the Council of State

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8 At the time of publication only an uncorrected transcription of the plenary debate and the votes in the House of Representatives on the emergency measures was available. https://www.tweedekamer.nl/kamerstukken/plenaire_verslagen/detail/15ed2634-f86b-4508-a624-1adbec0b45fc#id8edb8f7a