Raad van State

No.W06.22.0053/III/B 's-Gravenhage, 21 April 2022

April Report 2022

A. ASSESSMENT

1. Introduction

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. 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 Netherlands Bureau for Economic Policy Analysis; the Advisory Division has been charged with the more normative assessment of compliance with (European) fiscal rules.

In 2022, the Advisory Division will prepare three reports, one in April, June and September.[1] In the reports it provides an assessment of the expected budgetary developments and intentions as adopted by the government in, respectively, the Stability Programme, the Spring Memorandum and the Budget Memorandum

In the interest of quality and accuracy in drawing up the assessment for the April Report the Advisory Division was able to consult a draft version of the Stability Programme. On the basis of this, the Advisory Division has drawn up a draft assessment, which has been reviewed with the government on the principle of adversarial debate. The Division has made its final assessment after being informed of the government's response. The government's response is included in full in this report.

This report is structured as follows:

A. ASSESSMENT
 A.1. Introduction
 A.2. Summary conclusion and advice

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[1] In addition, in January 2022, the Advisory Division sent a letter containing recommendations on the government's budgetary policy to the Minister of Finance (Parliamentary Documents II 2021/22, 35788, No. C).

2. Summary conclusion and advice

2020 and 2021 were exceptional years in both social and technical budgetary terms. Because of the Covid-19 crisis, European fiscal policy provided Member States with maximum flexibility to deviate from fiscal targets by means of the general escape clause of the Stability and Growth Pact (SGP). Nationally, there was a deviation from the country's own budgetary rules due to the impact of the pandemic. In addition, in 2021 there was an election and a government formation process, which meant that new policies were largely delayed.

Therefore, for 2020 and 2021, there were no de facto anchors for fiscal policy, either at the European or national level. In previous advice, the Advisory Division has pointed out the importance, from a democratic perspective, of formulating anchors for budgetary policy in a transparent manner.[2] Formulating anchors ensures that decisions and possible reforms are weighed up in an integral manner based on politically chosen criteria.

In 2022, the general escape clause still applies to European fiscal policy. Due to the consequences of the war in Ukraine, it is still uncertain whether the escape clause will be deactivated in 2023. The European Commission's fiscal guidance for 2023 is formulated in qualitative terms, as in 2021 and 2022. This again provides a margin within the current fiscal targets. The outcome of the SGP’s evaluation, which may lead to changes in fiscal targets, the budgetary process and enforcement, will not be known until mid-2022 at the earliest. Implementation will take some time after that.

When assessed in relation to European fiscal rules - as they formally still apply, without prejudice to the escape clause and fiscal guidance - the Advisory Division concludes the following. The Dutch budget <u>does</u> comply with the requirements of the corrective arm of the SGP in 2021 (ex-post), in 2022 (in year) and in 2023 (ex-ante), but <u>not</u> with the rules of the preventive arm. In 2021 and 2022, the overshoots in the preventive arm of the SGP will not have any consequences, providing the sustainability of public finances is not jeopardised in the medium

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[2] Draft Budget Memorandum 2021 and September Report on Budgetary Monitoring, Parliamentary Documents II 2020/21, 35570, No. 3, W06.20.0288/III and Spring Report 2021, Parliamentary Documents II 2020/21, 21501-07, No. 1750, W06.21.0089.

term. Deactivation of the SGP's general escape clause must be taken into account for 2023.

The (new) government has established the national budgetary policy for 2022-2025. Orderly decision-making forms the basis of the principles of this budgetary policy. However, the full details of government policy are only presented in the Spring Memorandum, and the assessment of fiscal policy in budgetary frameworks by the CPB is then (only) presented with the Macroeconomic Outlook (MEV), which appears with the Budget Memorandum. At present, there are major macroeconomic uncertainties due, in particular, to the war in Ukraine, which are resulting in additional measures on the expenditure and tax side. Covering additional purchasing power measures using windfalls on the expenditure side violates the government's own budgetary rules. Moreover, since the government took office, several setbacks have been identified and the way in which they will be addressed remains unclear.

By and large, there is no return, either at the European or national level, to orderly fiscal policy with clear targets and anchors. Bearing this in mind, the Advisory Division issues the following advice:

I. An essential objective of the SGP is to guarantee the sustainability of public finances. The Advisory Division finds that the government's statement in the Stability Programme that *"the sustainability of public finances is not jeopardised in the medium term",* is insufficiently substantiated. The Advisory Division recommends justifying this position by indicating how the government addresses the difference between the medium-term budgetary objective for the Netherlands under the SGP for the structural balance (maximum -0.5% of GDP in 2022 and -0.75% of GDP in 2023) and the estimated structural balance for 2022 and 2023 of -3% and -2.8% of GDP respectively.

II. The (explanation of the) cohesion between financial and socio-economic government policy is limited in both the Coalition Agreement and the Stability Programme. Use this government's first Budget Memorandum, next Budget Day, to provide a coherent, more in-depth analysis and policy description, also from the perspective of broad prosperity. Cohesion between the Stability Programme, the Reform Programme and the Recovery and Resilience Plan to be submitted to the European Commission must be part of this analysis.

III. It is precisely in uncertain times that it is important for the government to implement predictable and secure budgetary policy based on the basic principles established for budgetary policy. Therefore, return to an orderly budgetary process with budgetary frameworks for expenditure and tax. This is essential for integral decision-making and imposes democratic considerations in budgetary policy.

The Advisory Division takes a positive view of the recently announced intentions to present a multi-year Spring Memorandum with (more) integral decision-making on the expenditure and tax side and thus also to achieve more timely parliamentary involvement in the budgetary process. This subsequently means that the House of Representatives must also fulfil its responsibility.

Finally, the Advisory Division observes progress in the transparent presentation of budget-relevant topics.

B. ANALYSIS

1. Relevant context

Advice: In the upcoming Spring Memorandum, take greater macroeconomic uncertainties into account and explain how the government will address any unfavourable (economic) developments in relation to its budgetary rules.

1.1 Macroeconomic uncertainties

In the March 2022 Central Economic Plan (CEP), the CPB Netherlands Bureau for Economic Policy Analysis states that the uncertainty caused by the war in Ukraine dominates the economic forecast.[3] Energy prices and inflation were increasing even before the start of the war in Ukraine. In the recovery from the Covid-19 crisis, the supply of goods cannot always keep up with the significant rise in demand, resulting in upward pressure on prices and problems in the supply chains. For the Netherlands, the main economic consequence of the war in Ukraine is currently even higher energy prices and thus even higher inflation. The Dutch economy is relatively sensitive to the price of gas, partly because of its large food and commodity sectors, and it is this price that has risen sharply. This means the current inflation rate in the Netherlands is among the highest in Europe. In its basic forecast, the CPB assumes a gradual decrease in energy prices, based on current futures contracts.

The CEP also includes a scenario with long-term higher energy prices. In the more detailed CEP, the CPB included an additional scenario based on a bleaker scenario in which energy and commodity prices continue to rise and other economic (confidence) effects occur. The CPB also states that other scenarios, both more and less favourable, are conceivable. In other words, the uncertainties are great.

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[3] CPB Netherlands Bureau for Economic Policy Analysis (2022). Central Economic Plan 2022. CPB forecast, March 2022.

Table 1: Key figures of macroeconomic developments

	Basic forecast			Scenario	
(changes in % per year, unless specified otherwise)	**2021**	**2022**	**2023**	**2022**	**2023**
The Netherlands					
Gross Domestic Product	4.8	3.6	1.7	1.9	0.0
Household consumption (volume)	3.5	4.7	1.5	3.5	-2.0
Investments by companies (excl. housing, volume)	4.7	3.1	3.3	-1.2	0.6
Relevant global trade volume in goods and services	7.5	6.6	4.9	2.5	2.8
Exports of goods and services	6.9	4.9	4.3	0.9	2.6
Imports of goods and services	5.2	5.5	5.5	1.7	3.3
National consumer price index (CPI)	2.7	5.2	2.4	7.9	3.9
CLA wage market sector	2.1	2.7	3.5	2.7	3.0
Purchasing power; static; median all households	0.1	-2.7	1.9	-5.1	0.6
Unemployed working population (level)	4.2	4.0	4.3	4.1	4.8
EMU balance (level in % of GDP)	-2.5*	-2.5	-2.3	-3.1	-3.5

* The EMU balance for 2021 has been adjusted on the basis of the actual figures for 2021 from CBS Statistics Netherlands, which appeared after the CEP.

Source: CPB Netherlands Bureau for Economic Policy Analysis (Detailed Central Economic Plan 2022, Table 4.1)

The uncertainties related to Covid-19 are decreasing. Moreover, the CPB no longer assumes there will be permanent macroeconomic damage due to Covid-19.[4] This means that the CPB expects the economy to return to the structural growth path prior to the Covid-19 pandemic. For the development of economic growth in the coming years, the course of the pandemic remains relevant, but its importance is diminishing.

However, there are uncertainties with regard to the European Central Bank (ECB) policy rate. Monetary policy in the US is already tightening in response to rising inflation. The ECB seems to have opened the door for winding down quantitative easing and an interest rate rise at the end of 2022. Early or late intervention by the ECB could lead to financial market shocks and damage the real economy and public finances. As economic developments are currently surrounded by great uncertainty, the timing of a possible interest rate increase is particularly complicated.

All in all, at the moment there are highly significant economic uncertainties with potentially major consequences for public finances. The 2022 Stability Programme describes the different scenarios of the CPB. However, it does not address the potential consequences of possibly less favourable scenarios, which are also not excluded by the CPB.

The Advisory Division considers it important to take these uncertainties into account in the Spring Memorandum and recommends explaining therein how the

[4] The possible (structural) effects on broad prosperity are not included.

government will deal with any unfavourable (economic) developments in relation to the budgetary rules it applied.

1.2 The budgetary picture is incomplete

The government compiles its Stability Programme on the basis of the CPB's CEP forecast. As explained (see above paragraph), this time the CEP is subject to exceptional uncertainty due to the consequences of the war in Ukraine. This also means the budgetary picture for 2022 and 2023 is uncertain. In addition, the government has not yet sufficiently elaborated all its policy intentions specified in the Coalition Agreement, so the budgetary and economic effects of the final detailed intentions may differ from the current forecast.

Moreover, the CEP does not incorporate all recent decision-making. For instance, the recently announced additional purchasing power measures and the recently announced reduction of the tax-free gift for purchasing a home as of 2023, have not been included in the forecast. The consequences of the Supreme Court ruling on the capital gains tax have not yet been decided, so the impact on the forecast is unclear and thus only included to a very limited extent. Finally, it does not yet take into account possible higher expenditure on the reception of refugees from Ukraine, a possible additional increase in expenditure on defence, a link between the increase in the minimum wage and the state pension, or potentially higher gas revenues.

After publication of the CEP, Statistics Netherlands (CBS) published new actual figures for public finances for 2021.[5] These actual figures differ from the figures presented for 2021 in the CEP forecast. However, the CBS figures only provide an update for the EMU debt and the EMU balance; they do not update the other indicators relevant for the budgetary assessment (such as the structural EMU balance and the expenditure rule), as the CBS does not produce series of these aspects.

Moreover, the CEP forecast does not include ceiling tests of expenditure frameworks and an assessment of the budget's revenue framework. The government will only formally establish the expenditure ceilings and the revenue framework in the Spring Memorandum. The CPB Netherlands Bureau for Economic Policy Analysis' Macroeconomic Outlook (MEV), which is published on Budget Day, will include ceiling tests for the expenditure frameworks and an assessment of the revenue framework, based on the new budgetary rules. The Spring Memorandum will include further details of the Coalition Agreement, which the CPB will include in the Macroeconomic Outlook.

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[5] Statistics Netherlands (CBS) (2022). Government deficit for 2021 down to 2.5 per cent of GDP https://www.cbs.nl/en-gb/news/2022/12/government-deficit-for-2021-down-to-2-5-percent-of-gdp.

1.3 Changes in the national budgetary process and reporting cycle

In its opinion on the Budget Memorandum 2022, the Advisory Division provided recommendations to parliament for reinforcing its rights associated with the budget.[6] The Advisory Division proposed, among other things, that from now on, the Budget Memorandum be submitted in the spring, so that the Dutch budgetary process is aligned with the European Semester and the House of Representatives and the Senate are better positioned to act in a more timely manner.

In 1994, the then Finance Minister Zalm introduced the main decision-making moment to the Dutch budget cycle. Since then, the government decides on the expenditure side of the draft budget for the following year in the second half of April, both to promote the integrality of budgetary considerations and to maintain calm in the budgetary process. With the current government taking office, on the advice of the 16th Study Group on Fiscal Policy, the main points of the tax side of the budget are currently also being decided, in order to further promote the integrality of decision-making. This affords the main decision-making moment in the spring even greater importance.

Previously, the main decision-making moment was considered an internal Cabinet affair. This meant that parliament only obtained an insight into the budgetary decision-making process on Budget Day. In response to the Advisory Division's advice on the Budget Memorandum, the government sent a letter to the House of Representatives proposing several alternatives for changing the budgetary process, with the aim of (1) giving parliament more time to debate the budget and the Tax Plan, (2) achieving greater substantive cohesion in the budget, and (3) aligning it more effectively with the European Semester.[7]

In the Letter to Parliament, the government cited a preferred variant, namely the introduction of a multi-year Spring Memorandum. This variant is characterised by a single main decision-making moment in the spring for both the expenditure and the tax side for the following year (t+1) and the years thereafter, instead of decisions only on the current year. The government intends to send a letter in the spring containing the fiscal intentions for the Tax Plan package and the planning for other tax legislation. A multi-year Spring Memorandum ensures that Parliament is involved sooner in budgetary decision-making on both the expenditure and tax side.

The Advisory Division takes a positive view of developments to increase parliamentary involvement in the budgetary process. Changes in the budgetary process also have an impact on the Advisory Division's reports in the context of independent budgetary monitoring. For 2022, it is known that the government will

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6 Parliamentary Documents II 2021/22, 35925, No. 3.

7 Parliamentary Documents II 2021/22, Letter to Parliament on the Budgetary Process, April 2022.

publish a multi-year Spring Memorandum.[8] Therefore, partly because the Stability Programme is (largely) lacking in policy and based on partly outdated macroeconomic assumptions, the Advisory Division will compile an additional report in June 2022, in the context of independent budgetary monitoring. For the years after 2022, the Advisory Division will review its reporting cycle, depending on the final structure of the budget cycle (i.e. in the spring).

1.4 Cohesion between the European Semester and the national budgetary process

The European Semester and the national budgetary process are not fully aligned in the spring. For example, the Stability and Reform Programme must be submitted to the European Commission by 30 April[9], while at the same time the decision-making process for the next financial year has not yet been completed. The Stability Programme must include the main budgetary and economic developments and also serve as a national medium-term budget plan (at least t+3).

As the Stability Programme does not yet include budgetary decisions for the following year, the document is generally limited in policy terms. This is certainly the case now that the budgetary picture is not yet complete (see Section B1.2). Moreover, the link between the Stability Programme, the country-specific recommendations of the European Commission and with the Reform Programme to be submitted is limited. If the (four-year) start of the multi-year national budgetary process is translated into the Stability Programme focusing more on policy, and there is greater cohesion with the Reform Programme, it will be possible to improve the quality of the Dutch contribution to the European Semester.

Incidentally, the Dutch government pursues trend-based fiscal policy with multi-year expenditure frameworks and a multi-year revenue framework (see also Section B3.1). This means that when a new government takes office this heralds the starting point for a new multi-year budget.

2. <u>Assessment under European fiscal rules</u>

Advice:

- *Justify the statement in the Stability Programme that the medium-term sustainability of public finances is not jeopardised by explaining how the government addresses the difference between the medium-term objective of a maximum structural deficit of 0.5% of GDP in 2022 and 0.75% of GDP in 2023 and the estimated structural deficit of around 3% of GDP in both years.*

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[8] Previously, the Spring Memorandum contained an overview of the state of affairs of the current financial year.

[9] For 2022, the Netherlands may integrate the Reform Programme and the Recovery and Resilience Plan yet to be submitted, submitting it later than April 2022.

- *Increase the substantive cohesion between budgetary decision-making, including investments and funds, the Stability Programme, the Reform Programme and the Recovery and Resilience Facility.*
- *In this government's first Budget Memorandum provide a coherent reflection on socio-economic and financial policies.*

2.1 European fiscal rules for 2021, 2022 and 2023
In its Spring Report, the Advisory Division assesses whether public finances in the previous year (*ex post*), in the current year (*in year*) and in the year ahead (*ex ante*) comply with European fiscal rules.

In March 2020, the European Commission declared the application of the provision in the Stability and Growth Pact (SGP) related to extraordinary events, thus excluding the budgetary impact of measures taken in response to the Covid-19 pandemic in the assessment of compliance with the SGP. The European Commission also activated the SGP's general escape clause, affording Member States maximum flexibility within the SGP to make additional fiscal efforts.[10]

Before the start of the Covid-19 crisis, the Netherlands was in the preventive arm of the SGP.[11] For Member States in the preventive arm the general escape clause means that they may deviate from the path towards the medium-term objective (MTO) for the structural balance, providing it does not jeopardise the sustainability of public finances in the medium term. The general escape clause does not suspend SGP procedures. Therefore, it remains important that the development of public finances is closely monitored and assessed.

The European Commission has linked the timing of the deactivation of the general escape clause to a quantitative target of reaching the pre-crisis GDP level (level at the end of 2019).[12] As part of the European Semester Spring Package 2021, the Commission noted that the pre-crisis GDP level in the euro area is expected to be

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[10] European Commission, Communication from the Commission to the Council on activating the general escape clause of the Stability and Growth Pact, COM (2020) 123 final.

[11] The SGP consists of corrective and preventive arms. The requirements of the corrective arm are a deficit rule of no more than 3% of GDP and a debt criterion 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 requirements of the preventive arm of the SGP consist of the medium-term objective (MTO), also known as the structural balance, and the expenditure rule. These requirements are intended to ensure that Member States implement countercyclical fiscal policy and include a safety margin in relation to the 3% deficit rule. The purpose of the preventive arm is to prevent Member States being confronted with excessive deficits. If there comes a point when Member States fail to comply with the rules within the preventive arm, the basic principle is that Member States are subject to the corrective arm. In both the corrective and preventive arms, there are a number of exceptions to the requirements, also known as flexibilities. For an overview, 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.

[12] European Commission (2021). Communication from the Commission to the Council. One year since the outbreak of COVID-19: fiscal policy response. COM(2021) 105 final.

reached in the first quarter of 2022.[13] On this basis, in the spring of 2021, the Commission announced that the general escape clause will also apply in 2022 and most likely be deactivated in 2023. Due to the uncertain economic situation resulting from the war in Ukraine, deactivation of the clause in 2023 is surrounded by more uncertainty. The Commission will review the timing of its deactivation in the spring of 2022.[14]

In 2021, no new excessive deficit procedures were opened, due to the extreme uncertainty related to the macroeconomic and budgetary impact of the Covid-19 crisis. Moreover, the European Commission will not propose opening new procedures in spring 2022, due to the remaining uncertainties surrounding Covid-19 and the current uncertainties resulting from the war in Ukraine. The European Commission will review this decision in autumn 2022.[15]

In 2021, Member States implemented expansionary fiscal policy in order to optimally support the economy during the Covid-19 crisis. The European Commission has recommended that Member States with low debt continue to pursue supportive fiscal policy in 2022. The Netherlands was recommended to implement, economic conditions permitting, fiscal policy aimed at sustainable public finances in the medium term in 2022. At the same time, public investment (sustainable and growth-enhancing) and structural fiscal reforms are needed, including in the areas of healthcare and social protection.[16]

The fiscal recommendations for 2023 (the so-called fiscal guidance from the European Commission), which serve as a guide for Member States in preparing their Stability Programmes, are, as in 2021 and 2022, formulated in qualitative terms.[17] In the fiscal guidance, the Commission aims for a broadly neutral (taken as an average for the entire euro area) fiscal policy in 2023, i.e. neither debt-increasing (expansionary) nor debt-reducing (consolidating). Member States with a high level of debt, i.e. (significantly) more than 60% of GDP, are recommended to establish a prudent debt reduction path. At the same time, nationally funded public investments should be encouraged and protected. The Stability Programmes must indicate how Member States are gradually reducing their public debt and working towards sustainable growth through reforms and investments. The fiscal

[13] European Commission (2021). 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. Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy. COM(2021) 500 final.

[14] European Commission (2022). Communication from the Commission to the Council: Fiscal policy guidance for 2023. COM(2022) 85 final.

[15] European Commission (2022). Communication from the Commission to the Council: Fiscal policy guidance for 2023. COM(2022) 85 final.

[16] European Commission (2021). Recommendation for a Council recommendation with advice from the Council on the stability programme 2021 of the Netherlands. COM(2021) 519 final.

[17] European Commission (2022). Communication from the Commission to the Council: Fiscal policy guidance for 2023. COM(2022) 85 final.

guidance per Member State will accompany the presentation of the European Commission's Spring Package in May 2022.

Box on the Recovery and Resilience Facility

The European Commission also consistently emphasises the role of the Recovery and Resilience Facility (RRF) in its fiscal guidance to Member States. The RRF is part of the European Next Generation EU recovery fund, which amounts to €800 billion and aims to promote economic recovery in Member States, contribute to convergence and cohesion in the European Union and to the green and digital transition.[18] The RRF consists of loans (€385.8 billion) and subsidies (€338 billion).

The Netherlands only claims subsidies from the RRF. The allocation of RRF subsidies is based on a calculation that includes the population size, GDP per capita, average unemployment and loss in real GDP for 2020 and 2021. The final distribution among Member States will be determined in mid-2022. The Netherlands is expected to receive a €4.7 billion subsidy from the RRF established by the European Commission (EC). To this end, the Netherlands must submit a Recovery and Resilience Plan (RRP) to the European Commission.

The Netherlands is the only Member State that has not yet submitted an RRP. An initial draft plan was recently sent to the House of Representatives.[19] The RRP must contain both investments and reforms that contribute to the Member State's recovery and make a long-term contribution to the digital and green transitions. At least 37% of the national envelope should be spent on the green transition, and at least 20% on the digital transition. It should also contribute effectively to challenges identified in the country-specific recommendations (CSRs) in 2019 and 2020. Investments and reforms decided after 1 February 2020 are eligible.

Future of the Stability and Growth Pact

For the years after 2023, the outcome of the evaluation of the SGP, the European Semester and the Macroeconomic Imbalances Procedure (MIP) is relevant. The five-year evaluation was suspended in 2020 due to the Covid-19 crisis. In the meantime, the European Commission has undertaken the review with the intention of presenting a communication on possible adjustments to the SGP in the summer of 2022.[20] Possible consequences of the war in Ukraine may lead to adjustments in the timetable.

In its fiscal guidance for 2023, the Commission lists a number of basic principles for a future fiscal framework.[21] The starting point is debt sustainability and promoting sustainable growth through investments and reforms. In addition, the

[18] Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility. OJ L 057, 2021

[19] Parliamentary Documents II 2021/22, 21501-07, No. 1827.

[20] For the different reform options and the legal framework, see also the Guidance of the Advisory Division on the possibilities for reforming the Stability and Growth Pact (W06.22.0005/III/Vo), Parliamentary Documents 2021/22, 35925, No. 146.

[21] European Commission (2022). Communication from the Council: Fiscal policy guidance for 2023. COM(2022) 85 final.

Commission states that the current framework depends on unobservable variables and has many flexible provisions, which makes it complex and less transparent. This calls for simpler fiscal rules based on a single operational rule, such as the expenditure rule. The Commission also considers greater focus on the medium term as promising (the Dutch multi-year expenditure and revenue frameworks are an example of this). In addition, there should be consideration of the lessons that can be learned from the structure, governance and implementation of the RRF. The focus must be on increasing Member State ownership, mutual trust, enforcement, interaction between the economy and fiscal policy and the European and national dimension. The European Semester should remain the framework for monitoring and the coordination of economic and labour market policy in the EU.[22]

Therefore, the guidelines for the budgetary assessment in 2020-2023 are largely qualitative, due to the exceptional events of the Covid-19 crisis and the war in Ukraine. However, the regular procedures of the SGP have not been suspended, so it remains important that the development of public finances is continuously assessed. Furthermore, no decision has yet been taken on possible reforms to the framework. At the same time, it is clear that there will be a continued focus on debt sustainability, investments and reforms and on increasing Member State ownership. All the more so since one of the SGP's essential objectives, as part of the EMU, is to guarantee the sustainability of public finances also in the longer term. Economic growth and convergence in the euro area is the other essential objective. Therefore, the Advisory Division will devote extra attention to this in the budgetary assessment.

[22] See also the Advisory Division's Guidance on the possibilities of reforming the Stability and Growth Pact (W06.22.0005/III/Vo, Parliamentary Documents 2021/22, 35925, No. 146) and Network of EUIFIs (2021). EU Fiscal and Economic Governance Review: A Contribution from the Network of Independent EU Fiscal Institutions.

2.2 Assessment for 2021, 2022 and 2023

On 25 March 2022, after the publication of the CEP, the CBS published new actual figures for public finances for 2021.[23] These actual figures are provisional and differ from the figures presented for 2021 in the CEP forecast. For example, the EMU balance in 2021 is -2.5% of GDP and the EMU debt 52.1% of GDP. This means that both the budget deficit and public debt are lower than estimated. The reasons lie in stronger revenue growth than previously expected. In addition, government expenditure is lower than previously estimated. An update for the other indicators relevant to the budgetary assessment, such as the structural balance and the expenditure rule, is missing.

With a budget deficit of 2.5% of GDP and government debt of 52.1% of GDP, 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.

Based on the outcomes of the CEP forecast (see Table 2), the structural balance in 2021 deviates significantly from the Dutch medium-term objective (MTO) of -0.5% of GDP. Moreover, the Netherlands does not comply with the expenditure rule based on the CEP forecast.[24] As a result, the Dutch budget does not comply with the rules of the preventive arm of the SGP. It is important to note that the consequences of the new actual figures supplied by the CBS, regarding the rules in the preventive arm are not yet fully known. The budgetary assessment in autumn 2022 will provide a clearer picture of 2021.

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[23] Statistics Netherlands (CBS) (2022). Government deficit for 2021 down to 2.5 per cent of GDP https://www.cbs.nl/en-gb/news/2022/12/government-deficit-for-2021-down-to-2-5-percent-of-gdp.

[24] The expenditure rule under the MTO comes into play if the adjustment path towards the MTO is not met. The aim of this rule is to ensure that a Member State moves towards the MTO.

Table 2: Figures for European fiscal rules 2021-2023

	2021 *ex-post*	2022 *in year*	2023 *ex-ante*
Rule in relation to the development of the structural balance (% of GDP)			
EMU balance (actual)	-4.4	-2.5	-2.3
Cyclical component	-0.7	0.5	0.6
One-off and other temporary measures	0.0	0.0	0.0
Structural EMU balance (EC method)	-3.8	-3.0	-2.8
Medium-term objective (MTO) structural EMU balance	-0.5	-0.5	-0.75
Expenditure rule			
Corrected collective expenditure (real change in %)	5.7	-2.4	-0.1
Max. permitted growth corrected net government expenditure**	-2.9	-4.7	-4.3
Debt criterion (% of GDP)			
EMU debt	55.1	53.8	53.1

* Collective expenditure, in accordance with European fiscal rules, has been corrected for interest expenditure,
cyclical expenditure on unemployment benefits, expenditure on EU programmes covered 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 for the structural EMU balance.

Source: CPB Netherlands Bureau for Economic Policy Analysis (Detailed Central Economic Plan 2022, Table 2.7)

For 2022 *(in year*) and 2023 *(ex-ante*), the Dutch budget also complies with the requirements of the corrective arm of the SGP (see Table 2). The Dutch budget does not currently comply with the rules of the preventive arm of the SGP in 2022 and 2023. The structural balance is expected to be -3.0% of GDP in 2022, which is 2.5% points higher than the medium-term objective for the structural balance of -0.5%. A structural balance of -2.8% of GDP is forecast for 2023, which means the deficit is 2.05% higher than the medium-term objective for the structural balance of -0.5% in 2023.[25] Compliance with the expenditure rule, which stipulates requirements for maximum permitted growth in government expenditure, is not expected in 2022 or 2023.

For 2021 and 2022, the general escape clause of the SGP is active and the extraordinary events provision has been declared applicable. Therefore, the overshoots in the preventive arm of the SGP have no consequences for 2021 and 2022. Usually, if Member States have not reached their MTO, they must move towards it in a path of 0.5% of GDP. The escape clause makes it possible for

[25] As of 2023, the government has opted for an MTO of a maximum of -0.75% of GDP, based on current
European Commission guidelines. Until 2023, the MTO for the Netherlands is -0.5% of GDP.

Member States to deviate from the path towards the MTO, providing it does not jeopardise the sustainability of the budget in the medium term.[26] Due to the extraordinary events provision, the budgetary impact of measures taken in response to the Covid-19 pandemic are not taken into account in the assessment of compliance with the SGP. However, the government does not report on this matter separately in the budgetary documents and the Stability Programme.

Deactivation of the SGP's general escape clause must be taken into account for 2023. At the moment, national budgets will be assessed by means of the qualitative fiscal guidance for 2023 (see also Section 2.1).

Table 3: Summary overview of the outcome of the assessment under European fiscal rules

	2021	2022	2023
Rules of the preventive arm:			
Structural EMU balance[(a)]	×	×	×
Expenditure rule	×	×	×
Rules of the corrective arm:			
Actual budget balance	✓	✓	✓
Government debt	✓	✓	✓

Explanatory note on symbols used: ✓ = compliance with the relevant rule; ○ = there is a deviation from the rule, but the deviation is not significant; × = there is a deviation from the rule, and calculated over 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% point of GDP. There is also a significant deviation if there is a deviation of at least 0.5% point of GDP cumulatively over two years.
(b) As long as the structural budget balance fulfils the medium-term objective, an assessment of the expenditure rule in the context of the MTO[27] may be omitted.

As the government indicates in the Stability Programme, the development of both government debt and the government deficit for both 2022 and 2023 is uncertain and forecasts and actual figures may differ considerably. Therefore, it remains important to monitor the (sustainability of) public finances (see Section B2.3), but also not to lose sight of the principles of national fiscal policy (see Section B3).

2.3 Sustainability of public finances in the medium term

As indicated, the development of public finances is uncertain. This makes it all the more relevant for the government to unambiguously communicate the basic principle for the medium-term budget. This provides short-term calm and clarity on

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[26] Article 5, first paragraph, Article 6, third paragraph, Article 9, first paragraph and Article 10, third paragraph of
Regulation 1466/97.
[27] Article 5, (1) (third paragraph) of Regulation 1466/97

the fiscal policy to be pursued and can prevent problems from being passed on to the future. Therefore, in its letter containing recommendations on the government's fiscal policy, the Advisory Division advised the following:[28] *"In the Spring Memorandum, make it clear which medium-term anchor(s) will be used and how they will be designed. Also clarify the budgetary anchors in the spring by means of multi-year balance and debt forecasts."*

Specifying the anchors used and why the budgetary situation is not only the outcome of policy, makes the budgetary situation part of policy considerations.

Box on the sustainability of public finances

An essential objective of the SGP is to guarantee the sustainability of public finances. Consequently, the sustainability of public finances in the medium and long term is an extremely important factor in the budgetary assessment. However, there are several ways of viewing the sustainability of public finances.

As a rule, the sustainability balance calculated by the CPB is used in the Netherlands as a benchmark for the sustainability of public finances. The CPB regularly publishes an update of the sustainability balance, which indicates the extent to which tax increases will be necessary in the future (target year 2060) to continue financing the current collective arrangements. The CPB approaches the sustainability balance from an intergenerational perspective: public finances must be financially sustainable and the corresponding government policy must treat different generations equally. The balance does not take into account possible future benefits, due to investments in, for example, education and the climate, which thus partly serve future generations. The balance also depends, among other things, on assumptions regarding structural versus incidental incentives, interest rates and economic growth, which means it is subject to uncertainty. However, the sustainability balance provides a good indication of the extent to which financial burdens are passed on to the future.

In the CEP, the CPB has included a scenario up to and including 2030, which provides insight into the development of the economy and public finances in the medium term. Such a forecast provides greater insight into the near future and may therefore appeal more to the imagination.

The European Commission also estimates the fiscal sustainability of Member States, which it publishes in the Debt Sustainability Monitor (DSM). The Commission uses two indicators to calculate medium-term sustainability. The first indicator shows the budgetary margin a Member State needs in the next five years in order for government debt to be below 60% of GDP in fifteen years' time. The second indicator defines sustainability as the adjustments in the primary balance sheet that need to be made immediately in order to make the debt financially sustainable. The second indicator is similar to the CPB sustainability balance, but is not identical: there may be technical differences in its operationalisation.

In addition to intergenerational sustainability, the perspective of financial markets is often considered when talking about sustainable public finances. Concerns about the

[28] Parliamentary Documents II 2021/22, 35788, No. C

affordability of government debt can push up interest rates for governments at a time when financial markets are demanding higher risk premiums for the government bonds of certain Member States. This could jeopardise debt affordability and access to debt financing for countries. Whether financial markets consider government debt sustainable depends not only on the level of debt itself, but also on other factors including monetary policy and, relevant for the EU, European fiscal policy. This means that it is not possible to define a strict threshold value.

In short, the sustainability of public finances is not an unambiguous concept and therefore not easy to answer with a yes/no question. Nevertheless, the different sustainability indicators do provide a good picture of public finances in the long term. Therefore, it is important to continue monitoring the sustainability of public finances.

Since a large part of the new government's policy will be introduced at the end of the government term or will get an additional boost after that, the Coalition Agreement will also have an effect after 2025. The CPB outlines these effects in its CEP forecast, looking ahead to 2030. Underlying this, the ageing of the working population is causing potential growth to slow down, while government expenditure on healthcare and state pension payments is rising. As a result, government expenditure is increasing faster than revenue, pushing up the deficit and debt towards 2030. The CPB expects the budget deficit to increase from -2.9% of GDP in 2025 to -3.5% of GDP in 2030. Debt is expected to increase from 53.1% GDP in 2025 to 61.0% in 2030.

In the analysis of the Coalition Agreement 2022-2025[29] the CPB estimated that as a result of the Coalition Agreement the financial burden on future generations will rise sharply. The sustainability balance deteriorates by 2.7% of GDP to -4.3% of GDP, which means that the structural budgetary incentive of the Coalition Agreement amounts to 2.7% of GDP until 2060. With this structural boost, public debt is expected to significantly exceed 60% of GDP.

The fiscal targets in the preventive arm provide insight into the medium-term sustainability of public finances. The medium-term objective (MTO) for a Member State is set for three years at a time in the form of a structural balance target. The structural balance is the budget deficit adjusted for cyclical influences, which means a structural deficit implies a deterioration of public finances in the medium term. The expenditure rule in the context of the MTO, which comes into play in the case of non-compliance with the adjustment path in the direction of the MTO, should ensure that the Member State moves towards the MTO. Failure to comply with both the MTO and the expenditure target in 2021-2023 will exacerbate the sustainability of public finances.

Based on the cumulative scale of the outcomes of the assessments in relation to the targets in the preventive arm of the SGP (distance to the MTO of over 2% of

[29] CPB Netherlands Bureau for Economic Policy Analysis (2022). Analysis of the Coalition Agreement 2022-2025. CPB Memorandum, January 2022.

GDP), the CPB estimates for 2030 and 2060, the uncertainties described in the budgetary decisions for 2023, and the major downside economic risks (see for instance the scenario in Table 1 with 0% economic growth in 2023), the Advisory Division finds that the government's statement in the Stability Programme that "*the sustainability of public finances is not jeopardised in the medium term"* is insufficiently substantiated.

The government's decision - understandably - to *use* "*budgetary scope to invest in major social challenges and boost sustainable growth*", according to the Stability Programme, does not in itself change this. It is up to the government to substantiate the risks it deems acceptable in the medium term and the taxes that are then deliberately left (partly) to the future (next generations).

2.4 Appreciation of proposed convergence and reform plans

The Dutch Reform Programme will not appear at the same time as the Stability Programme, but will be integrated in the Dutch Recovery and Resilience Plan, which is yet to be submitted. In the Stability Programme, the government specifies the ambitions in the Coalition Agreement regarding investments in climate, the housing market and education. The government also mentions that the Coalition Agreement announced measures to curb the rising costs of healthcare. However, it is limited to specifying what is already known from the Coalition Agreement; the explanation of the cohesion between financial and socio-economic government policies, also in the current, deteriorating international (economic threats) and national (budgetary setbacks) context is (too) limited, if not lacking. The Coalition Agreement itself also contains limited insight into the interrelationship between the government's financial and socio-economic policy.

The Advisory Division advises the government to improve the cohesion between its budgetary decision-making (Spring Memorandum), and in particular decision-making on investments and funds, and the Dutch Stability Programme, the Reform Programme and the Recovery and Resilience Plan to be submitted to the European Commission, and to clarify them, also for parliament.

It is also consistent with the Dutch tradition of considering financial and socio-economic policy in close conjunction. Traditionally, the Budget Memorandum sets out a vision of this policy. With the proposed changes to the budgetary process (see Section B1.3), the main elements of budgetary decision-making for the following year will be decided earlier in the year. The Advisory Division recommends that the scope this creates for the government be used next Budget Day, when its first Budget Memorandum will appear, for a more in-depth analysis of the cohesion between financial and socio-economic policy, also from the perspective of broad prosperity.

3. Assessment under national fiscal rules

Advice: In the context of existing budgetary setbacks and uncertainties, explain more clearly in the budgetary rules when exceptional circumstances justify policy interventions outside the agreed budgetary frameworks.

3.1 The national fiscal rules for 2021, 2022 and 2023

Since 1994, successive governments have opted for trend-based fiscal policy. In the Initial Policy Memorandum to the Coalition Agreement the government established and confirmed that it will pursue trend-based fiscal policy.[30] On the expenditure side, multi-year expenditure frameworks (State Budget, Social Security, Healthcare and the new Investment Framework) are established, each with an annual expenditure ceiling that may not be exceeded. On the revenue side a revenue framework applies with 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's term.

A new element is the windfall formula, which comes into effect if the forecast of the actual EMU balance is better than a balance of -1% of GDP in the long term. Windfalls usually benefit government debt. The same applies to setbacks; as these also benefit government debt, the automatic stabilisers, characteristic of trend-based fiscal policy, can do their job. The windfall formula earmarks 50% of the actual long-term margin above the EMU balance of -1% of GDP for tax relief and 50% for debt repayment. Decisions on this matter will be taken in the spring.

While the previous government opted to keep the extra expenditure related to the Covid-19 pandemic outside the regular expenditure ceiling, so that no cuts would have to be made to other expenditure that would worsen the EMU balance and increase the EMU debt,[31] this government has opted to consider on a case-by-case basis whether any new support measures will be placed inside or outside the expenditure ceiling. The reason for this is that the fight against the (economic) consequences of Covid-19 has entered a new phase. The basic principle applied is that measures fall under the ceiling unless there are good reasons to deviate from it.

Dutch fiscal policy is based on the following basic principles:
1) The efficient allocation of public funds,
2) Control of public finances and
3) A contribution to economic stability.

This objectives are best achieved through stability and calm in political decision-making, by performing integral considerations of different policy objectives at fixed times. This also promotes orderly political accountability of the government to parliament. Therefore, in the budgetary process, the government opts for a

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[30] The Rutte IV Government Initial Policy Memorandum, Parliamentary Documents II 2021/22, 35925, No. 143.
[31] Autumn Memorandum 2020, Parliamentary Documents 2019/20, 35650, No. 1.

single integral main decision-making moment in the spring for the main lines of both the expenditure and tax side of the budget. At that time, various political wishes, problems, windfalls and setbacks can be weighed up in an integral manner.

3.2 *Assessment for 2021, 2022 and 2023*

The national budgetary rules established by the previous government applied in 2021. The Covid-19 crisis also dominated a large part of 2021. Support measures were implemented in addition to the automatic stabilisers on the income and expenditure side. Financing these measures required a temporary deviation from Dutch budgetary rules. For standard policy the government adhered to the applicable budgetary rules, to maintain as much calm and predictability in the budgetary process as possible.

From 2022 onwards, the national budgetary rules of the new government apply, which are described in Section B3.1. Orderly decision-making constitutes the foundation of the basic principles of fiscal policy. This is important from a democratic point of view, because it requires the necessary decisions to be taken. The formulation of budgetary policy ensures that decisions and possible reforms are weighed up integrally on the basis of politically chosen criteria. A single main decision-making moment for both the expenditure and the tax side of the budget contributes to this.

The government is operating at a time when, on the one hand, financial resources are plentiful and, on the other, there are major social tasks for the future that require substantial investments and reforms. In addition, there are major uncertainties in the short term due, in particular, to the war in Ukraine and the (aftermath of the) Covid-19 crisis.

In uncertain times, it is particularly important for the government to maintain calm and implement predictable and secure fiscal policy based on the basic principles of efficient allocation, control and macroeconomic stabilisation. This is stated by the government in the Initial Policy Memorandum: *"Controlling public finances means, first and foremost, that a government has control of the development of revenue and expenditure and adheres to the (budgetary) agreements made."*[32]

Control, but also stabilisation, is achieved by respecting the agreed frameworks and only allowing policy interventions outside the regular budgetary processes and outside the multi-year frameworks in the case of exceptional circumstances. By doing so, the government undertakes to adhere to the long-term vision laid down in the Coalition Agreement, to weigh decisions on various expenditure and revenue integrally at a single decision-making moment and to avoid ad hoc adjustments. If a government feels compelled to adjust policy due to relevant

[32] Parliamentary Documents II 2021/22, 35925, No. 143.

developments and growing insight, reprioritisation should take place before existing agreements are violated.

The government has introduced a windfall formula, which can be used if the forecast of the EMU balance is better than a balance of -1% of GDP in the long term. If that happens, 50% of the margin created above the EMU balance of -1% of GDP can be allocated to tax relief and 50% to debt repayment. However, given an estimated structural balance of -3.0% of GDP in 2022 and -2.8% of GDP in 2023, its application is not on the horizon for the time being. In addition, the government states in its Initial Policy Memorandum that the reallocation of on balance expenditure windfalls for new policy can only take place after integral decision-making in the Council of Ministers. By doing so, the government provides itself with a margin to use expenditure windfalls for structural new expenditure (policy), contrary to the budgetary rules.

Since the beginning of the government term, several setbacks have been announced and additional purchasing power measures have been decided upon. It is still unclear how the setbacks will be covered. However, it has already been announced that the additional purchasing power measures will be covered by windfalls on the expenditure side.[33] This constitutes non-compliance with its own budgetary rules. The danger is that, at a time when we seem to be moving from one crisis to another, budgetary commitments are too easily set aside. And yet, especially in uncertain times, they force us to weigh up the efficiency and effectiveness of measures. This is particularly questionable in the case of generic compensation measures. After all, the funds for such compensation measures must also be raised. Therefore, the Advisory Division considers it important to justify when exceptional circumstances provide a rationale for policy interventions outside the agreed frameworks.

[33] Parliamentary Documents II 2021/22, 35925, No. S.

4. Focal points related to the expenditure frameworks

Advice:
- *Provide clarification, at the latest by the Spring Memorandum, with regard to the timetable and the structure of both the individual budgetary funds and the rules for the Investments sub-ceiling.*
- *Include the perspective of broad prosperity in the problem analysis during the agenda-setting phase of the policy chain. Possible effects involved in implementation should also be identified during this phase.*
- *Provide details of the intentions for this government term regarding the improvement of the financing system for local and regional authorities no later than the Spring Memorandum.*
- *Continue to critically monitor outstanding guarantees and consider if and when it is necessary to deviate from certain principles within the risk scheme policy.*

4.1 Risk of underutilisation
The government has extensive investment ambitions and other policy intentions. Cumulatively over 2022-2025, this involves additional expenditure of €75 billion. However, there is a risk of underutilisation and, consequently, of ambitions being achieved later or not at all. For example, as also mentioned in Section B1.2, not all intentions are currently concrete enough to result in expenditure in the short term. It is also possible that after further elaboration, the budgetary scope of the plans will have to be changed. Another risk is that, given the large number of investments and considerable intensification, fully developing the plans may prove very challenging. For some of the policy intentions, it is not only the policymakers of ministries on the government side who have to take action, but also more executive departments and local and regional authorities, where bottlenecks already exist.

There are also bottlenecks in the market, both in the labour market and in the supply of goods and materials. This can lead to higher prices for personnel and materials, but also to the failure in achieving certain policy intentions because the right professionals and materials are not available. Finally, the additional spending and jobs in the public sector may eventually crowd out economic activity in the market sector, as expected by the CPB.[34] In the CEP forecast the CPB already assumes underutilisation of expenditure on education, defence and the National Growth Fund. This underspending partly leads to higher expenditure in later years.

Underutilisation indicates problems in one or more phases of the policy chain, which starts with policymaking and ends with actual implementation. The Advisory Division considers it important that during the policymaking phase, sufficient attention is devoted to possible bottlenecks in the chain as a whole, that

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[34] CPB Netherlands Bureau for Economic Policy Analysis (2022). Detailed Central Economic Plan 2022. CPB forecast, March 2022.

these are identified and that, given the identified bottlenecks, that there is consideration of how policy intentions can be implemented. Otherwise, particularly urgent and major transitions risk not being realised or being delayed.

4.2 Budgetary funds

A substantial part of government expenditure takes place through funds. Within the expenditure framework, the government has created an additional Investments sub-ceiling, which means the total expenditure ceiling currently consists of four sub-ceilings. The sub-ceiling includes the budgets of the Mobility Fund, the Delta Fund, the Defence Materiel Fund, the National Growth Fund, as well as the new Climate Fund and the Nitrogen Fund from the Coalition Agreement.

For expenditure that falls under the investment ceiling, funds may be freely reallocated to subsequent years. The rules of the Investment sub-ceiling and the organisation and governance of the various funds still need to be elaborated. In the letter containing recommendations on budgetary policy, the Advisory Division recommended that, when designing the new investment funds, explicit attention should be devoted to designing the governance method, guaranteeing parliament could effectively exercise its rights associated with the budget.[35] The Advisory Division recommends, in addition to the previous recommendation, that clarity be provided with regard to the timeline and the design of both the separate new budget funds and the rules for the Investments sub-ceiling, no later than the Spring Memorandum, thus providing timely insight into use of the funds.

4.3 Article 3.1 Government Accounts Act (CW)

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.[36]

As the government also states in the Stability Programme, high quality public finances are essential for the effective and efficient deployment of public resources. In the letter containing recommendations on budgetary policy, the Advisory Division recommended improving the chain of policy, legislation and implementation by not (unintentionally) using the various existing instruments aimed at transparency, effectiveness and efficiency in isolation, but rather using them together. In the chain, attention must be paid to indicators of broad prosperity.[37]

The CW 3.1 requirements are an integral part of the broader justification in the Integral Assessment Framework (IAK) of proposals for policy and regulation. At

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[35] Parliamentary Documents II 2021/22, 35788, No. C.
[36] Parliamentary Documents II 2021/22, 31865, No. 198.
[37] Parliamentary Documents II 2021/22, 35788, No. C.

the beginning of the policy chain in the agenda-setting phase, a good problem analysis is required: to what extent and in what way does a proposal provide a solution to an identified problem?

The Advisory Division recommends including the perspective of broad prosperity in the problem analysis, which would also provide insight into the effectiveness of the proposal. The problem analysis must also answer the question of whether there are positive or negative secondary effects of the proposal on other policy areas. Possible effects of the implementation will already need to be mapped out during this phase. This would make it possible to examine whether the advantages of the proposal outweigh the disadvantages and the extent to which a proposal contributes to broad prosperity. Moreover, it is important to examine which assumptions regarding the expected (behavioural) effects underlie the proposal.

These questions should be posed and answered during the policy-forming phase. The more effectively the policy can be substantiated, the better the possible resulting legislation can also be justified. And the greater the insight into the aspects involved in the implementation at an early stage. These are not questions to be answered retrospectively in the form of a 'checklist'.

4.4 Multi-year budgetary framework for local and regional authorities

In the letter containing recommendations on budgetary policy, the Advisory Division recommended that a transparent and multi-year budgetary framework be established, for and with local and regional authorities in the spring of 2022, replacing the current accrual system.[38] The government has set itself the objective of achieving more stable funding for local and regional authorities for the period after 2025. However, during the current government term, financing will largely continue to take place via the existing standardisation system (accruals and 'step up, step down'), while at the same time deviating from this system in a number of respects, particularly in the accruals calculations. The Advisory Division also stated that the current standardisation system provides insufficient stability, resulting in a deterioration of intergovernmental cooperation. Furthermore, additional measures resulting in financial consequences for local and regional authorities included in the Coalition Agreement lead to an unstable, complex and not particularly transparent multi-year budget for local and regional authorities.

A multi-year budgetary framework for local and regional authorities ensures financial security and administrative stability for the longer term and offers the State and local and regional authorities an opportunity to settle potential disputes regarding financial matters in an orderly manner. Financial security is all the more important at a time when major social challenges and transitions require implementation and investment by local and regional authorities. The Advisory Division once again asks for attention to be devoted to the establishment of a multi-year budgetary framework for local and regional authorities and requests the

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[38] Parliamentary Documents II 2021/22, 35788, No. C.

government elaborate on its intentions for this government term with regard to improving the financing system for local and regional authorities no later than the Spring Memorandum.

4.5 Risk schemes

The Advisory Division has pointed out the uncertainties and risks of outstanding guarantees in previous reports. The government adopts a ‘no, unless' policy with regard to risk schemes (guarantees and loans). Proposals for new risk schemes and adjustments to existing schemes are part of the main decision-making moment in the spring and subject to an assessment framework, included in the Initial Policy Memorandum.[39] The risk scheme assessment framework is sent to parliament when a new risk is assessed. For large and complex risks, the government requests a second opinion from an independent specialist party in relation to risk management and premium setting.

In response to the Covid-19 crisis, the government attempted to partially eliminate uncertainties in the economy by means of various risk schemes. At the European level too, risk schemes have been set up for this purpose, for which the Netherlands is a partial guarantor. In addition to existing schemes, sixteen additional guarantees and twelve loans were outstanding in 2021 as a result of the Covid-19 crisis. The guarantees amount to approximately €38 billion, of which €33 billion are international guarantees. The government indicates that it is temporarily deviating from a number of principles within the risk scheme policy, due to the urgency and severity of the crisis.

The Advisory Division has previously pointed out the importance of critically monitoring outstanding guarantees, informing parliament where necessary, and phasing out guarantees if the economic situation allows. The Stability Programme explained that the total amount of government guarantees as a share of GDP has decreased from 29.2% of GDP in 2020 to 24.6% of GDP in 2021. Therefore, the total amount of outstanding State guarantees will be €211.8 billion in 2021. The outstanding guarantees are expected to amount to €210.9 billion in 2022, of which approximately €41 billion are related to the Covid-19 crisis.

By means of the assessment framework and monitoring in the Stability Programme, the government strives to make transparent and well-considered choices regarding both new and existing guarantees. The Advisory Division supports this approach and asks the government to continue to critically monitor outstanding guarantees and to consider if and when it is necessary to deviate from certain principles within the risk scheme policy in the future.

4.6 Transparency

Budgetary transparency is of great importance for a well-founded assessment of government policy by parliament and for creating support for policy in society. For

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[39] Parliamentary Documents II 2021/22, 35925, No. 143.

this reason, in its budgetary reports the Advisory Division reflects on the extent to which the government satisfies this need.

In general, the Advisory Division notes progress in the transparent presentation of budget-relevant topics. In the 2020 September Report on Budgetary Monitoring, the Advisory Division expressed a preference for presenting expenditure on account of the Covid-19 pandemic and related support measures separately (whether or not in a separate box) from the expenditure ceilings.[40]Furthermore, in the 2020 September Report on Budgetary Monitoring the Advisory Division advocated for the critical monitoring of the financial impact of the newly established risk schemes and the expansion and relaxation of conditions of various existing guarantee schemes within the framework of the support and recovery packages.[41] Both overviews have been included by the government in the Stability Programme.

In the Initial Policy Memorandum, the government provided insight into the multi-year horizontal (year-on-year) development of expenditure and taxes. Previously, the focus was on the vertical change, i.e. the change from the baseline. As a result, there was a lack of insight into the total development of expenditure and taxes (including the development that was already included in the baseline, e.g. demographic developments). The Advisory Division sees this development as a step towards increasing the transparency of budgetary information.

However, there is also room for improvement. In its advice on the Budget Memorandum 2022, the Advisory Division suggested the Initial Policy Memorandum should not only express the tax burden in billions of euros, but also provide insight into the tax burden expressed as a percentage of GDP. This would allow a distinction to be made between policy-based and endogenous changes in taxes, and provide clarification of how the tax burden is distributed between citizens and businesses, labour and capital, and various expenditure categories such as goods, energy and the environment. However, such a presentation of the tax development has not yet been included in the budget documents.

5. Focal points related to the tax framework

Advice:

- *Provide a comprehensive picture of the size and risks related to tax liabilities resulting from the Covid-19 crisis in the Spring Memorandum. Include an annual summary of this in the Stability Programme.*
- *Provide insight into how the changes in the budgetary process will affect the process for the Tax Plan package and fiscal legislation.*

5.1 Tax liabilities as a result of the Covid-19 crisis

[40] Parliamentary Documents II 2020/21, 35570, No. 3.
[41] Parliamentary Documents II 2020/21, 35570, No. 3.

The government supported affected entrepreneurs during the Covid-19 crisis by means of an extensive package of support measures, including generic tax deferrals and new schemes such as the NOW (Noodmaatregel Overbrugging voor Werkgelegenheid/Emergency measure for bridging employment), the TVL (Tegemoetkoming Vaste Lasten/Reimbursement of fixed costs) and the Tozo (Tijdelijke overbruggingsregeling zelfstandig ondernemers/Temporary bridging scheme for the self-employed). This has contributed to a rapid recovery of the Dutch economy. However, some entrepreneurs, especially in the hard-hit sectors such as hospitality, events and retail, have had to draw on reserves or accrue debt.

The Letter to Parliament on the long-term vision of Covid-19 support reveals a mixed picture of the current and expected extent of debt-related problems entrepreneurs are facing.[42] On the one hand, there is no reason for concern (yet) at the macro level, but on the other hand, there are indications, based on a study by De Nederlandsche Bank (Dutch Central Bank (DNB)), that a substantial number of companies in the worst affected sectors are facing liquidity and solvency issues.[43] Outstanding tax liabilities on 24 February 2022 amount to more than €20 billion at 278,000 companies.

The government will end the Covid-19 financial aid packages as of 1 April 2022. This is expected to potentially lead to an increase in bankruptcies and job changes. An important part of the possible budgetary consequences of tax liabilities as a result of Covid-19 is the extent to which entrepreneurs are able to repay their debts. Despite the favourable repayment arrangements (repayment period of five years) and extensive range of instruments to support entrepreneurs with problematic debt, the Advisory Division identifies a possible risk to public finances in the repayment of deferred tax liabilities for the hardest hit sectors. In order to properly assess this risk, a comprehensive picture of the current and expected extent of entrepreneurs' debt issues is required. The Advisory Division recommends the government include a comprehensive overview of this matter in the Spring Memorandum and to report on it in the Stability Programme from now on.

5.2 Budgetary process on the tax side

As described in Section B1.3, parliament will be involved in decision-making on both the expenditure and the tax side from now on in the spring.[44] In its preferred variant, the government proposes announcing the contents of the Tax Plan package earlier by means of a letter in the spring. The letter contains the government's tax-related intentions for the Tax Plan package and the planning for other tax legislation. This allows parliament to debate the proposed tax legislation

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[42] Parliamentary Documents II 2021/22, 35420, No. BX

[43] De Nederlandsche Bank (Dutch Central Bank (DNB)) (2022). The influence of the Covid-19 support and recovery package on the Dutch business community.

[44] Parliamentary Documents II 2021/22, Letter to Parliament on the Budgetary Process, April 2022.

and provides time for the legislation to be fleshed out before the Tax Plan is actually submitted in September. The government indicates that it aims to stagger the legislation it submits as much as possible.

The Advisory Division welcomes the developments regarding the budgetary process, including on the tax side. At the same time, it is still unclear how the changes in the budgetary process will affect the process involved in the Tax Plan package and tax legislation. For example, the level of detail of the intended letter in the spring is still unknown, which is relevant to the extent to which the debate between the Government and the House can be held.

6. Fulfilment of commitments previously made by the government

In the letter with recommendations on budgetary policy dated January 2022, the Advisory Division issued four recommendations on the budgetary policy of the government formed this year.[45] This April Report contains a number of additional recommendations for the Spring Memorandum 2022. In the Report related to the Spring Memorandum, the Advisory Division will reflect on the government's follow-up to the recommendations and the resulting commitments.

C. RESPONSE FROM THE GOVERNMENT

The government would like to thank the Advisory Division of the Council of State (hereinafter: the Advisory Division) for its assessment of the Stability Programme (SP) 2022. The SP describes the development of Dutch public finances. The Advisory Division has assessed the extent to which this development complies with the rules of the Stability and Growth Pact (SGP).

In the Spring Report the Advisory Division assessed whether public finances comply with European fiscal rules in 2021, 2022 and 2023. The Advisory Division concludes that Dutch public finances in 2021 satisfied the rules of the corrective arm of the Stability and Growth Pact (SGP). On the other hand, they do not comply with the rules of the preventive arm of the SGP. In 2022 and 2023, the budget is also expected to comply with the corrective arm, but not with the rules of the preventive arm. The structural balance is expected to be -3.0% of GDP in 2022, 2.25% points lower than the medium term objective (MTO) of -0.75% of GDP. The CPB forecasts a structural MTO balance of -2.8% of GDP for 2023. Moreover, the Dutch budget does not meet the expenditure rule in 2022 and 2023. Due to the exceptional crisis, the European Commission activated the general escape clause of the SGP in March 2020. The Advisory Division states that, as a result, exceeding the targets in the SGP for 2022 will not have any consequences for the Netherlands. The Advisory Division expects the general escape clause to be deactivated in 2023 and asks the government to consider how budgetary policy will relate to European fiscal rules at that time. The

[45] Parliamentary Documents II 2021/22, 35788, No. C

Advisory Division reiterates the advice it issued in January, to clarify which medium-term anchors will be used.

The government agrees with the Advisory Division's assessment that the rules of the preventive arm of the SGP have not been met. The government also agrees with the conclusion that activation of the escape clause, as part of the SGP, offers scope for deviating from European targets this year. The government has opted for an ambitious investment agenda and is aware that this may cause tension with European fiscal rules. The Coalition Agreement contains ambitious investments, which are necessary for the future of the Netherlands. The government deliberately opted to do this, convinced that society will benefit from the investments and that delaying them will lead to higher costs and a loss of broad prosperity in the future. Since this additional expenditure will lead to a short-term deterioration of public finances, it is important to continue monitoring the development of public finances and to maintain the frameworks. In the Spring Memorandum, the government will address setting the expenditure ceilings and the revenue framework.

The Advisory Division goes on to state that failure to comply with the rules in the preventive arm will lead to a deterioration in the sustainability of public finances. It indicates that the decisions taken by the government are understandable, but the Stability Programme does not offer sufficient substantiation that there is no risk to the sustainability of public finances in the medium term.

The government appreciates the fact that the Advisory Division draws attention to the sustainability of government debt in the medium term. The government recognises that the ambitious investment agenda has a significant impact on the development of the balance and debt and thus the sustainability of public finances. This requires a careful balance. The government will further explain this interpretation both in this government response and the Budget Memorandum.

In the debate on sustainability, it is important to make a clear distinction between financial debt sustainability and the intergenerational distribution of the debt and benefits of public policies. With regard to financial debt sustainability, the government deems the policy to be justified: the favourable financing conditions of the Dutch government - also in comparison with similar countries - demonstrates confidence in financial markets. This applies both to the initial financial positions and to the capacity for financial management of the debt. With regard to intergenerational distribution, the government is taking the significant decision to invest in social challenges for the benefit of future generations. Tackling major social challenges will prevent the related costs from rising further in the future.

The increase in government debt remains limited despite the additional expenditure: the CPB forecasts an increase to 61 per cent of GDP in 2030. The government temporarily accepts a higher debt in order to resolve social challenges and will subsequently aim to decrease the debt. In the medium term, the government is taking measures to curb the growth of healthcare costs, which will contribute to responsible debt development.

Lastly, the Advisory Division mentions that the explanation in the Stability Programme of the cohesion between financial and socio-economic government policy is too limited. The Coalition Agreement also provides insufficient insight into this matter. Therefore, the Advisory Division recommends clarifying the cohesion between budgetary decision-making and the Stability Programme, Reform Programme and the Recovery and Resilience Plan.

The government recognises the importance of good communication with regard to the cohesion of different components of socio-economic policy. Traditionally, the Budget Memorandum contains a vision of the government's policy. In the forthcoming Budget Memorandum, the government will, in line with the Advisory Division's advice, include a more in-depth analysis of the policy’s cohesion, including from the perspective of broad prosperity.

In addition to the assessment of European fiscal rules, the Advisory Division also assessed national fiscal rules for 2021, 2022 and 2023. In this regard, the Advisory Division stresses the importance of a single main decision-making moment and an orderly budgetary process. Predictable and secure fiscal policy is particularly important in times of uncertainty. Next, the Advisory Division notes that the lack of compliance with national budgetary rules, given that additional purchasing power measures in March this year were covered by windfalls on the expenditure side. According to the Advisory Division, it is necessary to justify when it is permissible to intervene outside the framework in exceptional circumstances.

The government agrees with the importance of restoring calm in the budgetary and decision-making process. An orderly process contributes to improved and more integral considerations of efficiency and effectiveness. It also prevents potential irregularities. In addition, the government endorses the need for budgetary rules and a return to regular budgetary policy with the familiar expenditure ceilings and the revenue framework. This is essential for ensuring integral decision-making. It ensures that the benefits and costs of various proposals are weighed up and contribute to the controlled development of public finances.

At the same time, in March this year, there was an exceptional situation in which gas prices led to serious windfalls on the expenditure side, while the (necessary) repair of purchasing power led to losses on the revenue side. For the government, it was extremely important that the purchasing power measures were covered to prevent the bill for relief from being passed on to future generations. In this exceptional case, the social interest outweighed the separation of revenue and expenditure as prescribed in the budgetary rules.

If exceptional intervention is required, the government recognises the importance of this being properly motivated and substantiated. At the same time, the government does not consider it possible to specify the budget rules for every possible scenario in advance. In the case of unforeseen circumstances, such as the Covid-19 crisis, it is important to apply the budgetary rules in the way that the exceptional situation requires.

The Advisory Division goes on to draw attention to possible underutilisation, given the extensive investment ambitions and other policy intentions. The government recognises that the planning of physical investments is surrounded by uncertainty. The scale of the investment task and the current labour shortage make this uncertainty even greater. The Investments sub-ceiling, which is being used for the first time this government term, helps mitigate the effects of these planning risks. The new investment ceiling offers greater flexibility to adjust the rhythm of investment, as the ceiling automatically moves alongside it when investment expenditure is shifted to later years, for example, due to delays in investment projects. As a result, planning risks involved in physical projects will have less of an effect on the scope for other expenditure. The government endorses the Advisory Division's advice to keep an eye on the risk of underutilisation and remains committed to doing so.

The government uses funds for part of the expenditure, including the new Climate Fund and the Nitrogen Fund. The Advisory Division reiterates the advice issued in the letter in January containing recommendations on fiscal policy, to devote attention to the design of the funds in terms of governance and the parliamentary budget. In the Initial Policy Memorandum, the government indicated that the design and governance of the various funds would be elaborated in the coming period. The government will provide clarity on this matter in the Spring Memorandum at the latest.

The Advisory Division indicates that the requirements of Article 3.1 of the Government Accounts Act (CW) are an integral part of broader accountability in the 'Integral Assessment Framework for Policy and Regulation' proposals (IAK). The Advisory Division states that an effective problem analysis is required at the beginning of the policy chain. The Advisory Division recommends including the perspective of broad prosperity therein. The government endorses the importance and added value of broad prosperity. Currently, the government is working on responding to the Hammelburg et al. motion requesting the government integrate broad prosperity in the budgetary and accountability cycle. In this Letter to Parliament the government also returns to the role of broad prosperity in policy preparation and evaluation.

The Advisory Division reiterates its advice to establish a transparent and multi-year budgetary framework for and with local and regional authorities and thus replace the current accruals system. The government recognises the importance of effective agreements with local and regional authorities. The government is engaged in discussions with local and regional authorities about the financing system and will address the state of affairs in more detail in the Spring Memorandum.

In the Spring Report, the Advisory Division reiterated the importance of critically monitoring outstanding guarantees, informing parliament where necessary and phasing out guarantees if the economy allows. In addition, the Advisory Division suggests that consideration be given to whether and when it is necessary to deviate from certain principles in the risk scheme policy.

The government endorses the importance of critically monitoring outstanding guarantees and phasing them out when possible. This process is under way in the area of crisis-related risk schemes. Also, applying the 'no, unless' policy to regular risk schemes automatically leads to the outstanding risk decreasing when the economy normalises. The government does not consider it desirable to indicate in advance when crisis schemes are permissible, as it is impossible to anticipate every conceivable scenario.

On the subject of tax, the Advisory Division recommends that the Spring Memorandum include a comprehensive picture of the debt problems facing entrepreneurs. The Annual Financial Report of the Kingdom and the Budget Memorandum will discuss the current financial state of affairs regarding Covid-19 debts. In the Spring Memorandum, the government will also discuss this issue and explain how it will affect the budgetary outlook. More detailed information on entrepreneurial debt can be found in specific monitoring letters.

Lastly, the government appreciates the fact that the Advisory Division notes progress in the transparent presentation of budget-relevant issues. At the same time, the Advisory Division indicates that there are areas for improvement. The government underlines its commitment to transparency and will continue its efforts to communicate tax development as transparently as possible.

The Minister of Finance,

Sigrid. A.M. Kaag

The response from the government has not prompted the Advisory Division to change its assessment. In the upcoming June and September Reports, the Advisory Division will discuss the implementation of the commitments.

The Vice-President of the Council of State,