Raad van State

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A. ASSESSMENT

1. Introduction

The Advisory Division of the Council of State, as the independent budgetary monitoring institute, is charged with drawing up periodic assessments of whether the government complies with European fiscal rules.

The publication of the Spring Memorandum 2022 serves as an update and provides details of the policy intentions, corresponding budgetary frameworks and budgetary policy for the coming term of government, in relation to the Initial Policy Memorandum of the Rutte IV Government. The Spring Memorandum follows the Stability Programme that the Dutch government submitted to the European Commission and the States General in April of this year. In the context of independent budgetary monitoring, in the April 2022 Report, the Advisory Division assessed the Stability Programme with regard to European and national fiscal rules and issued recommendations in relation to the Spring Memorandum.[1]

As announced in its April Report, in its capacity as an independent budgetary monitoring institute, in this June Report the Advisory Division provides an assessment of the Spring Memorandum and discusses the government's implementation of its policy intentions, partly based on the April Report.

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[1] Parliamentary Documents II 2021/22, 21501-07, No. 1840.

2. Summary conclusion and advice

From now on, the government intends to submit to parliament its main decisions on public expenditure and taxes for the subsequent year in the Spring Memorandum (May/June) instead of in the Budget Memorandum (September). In its capacity as the independent budgetary monitoring institute, the Advisory Division considers this government's first Spring Memorandum to be a good start. However, the design of the new budgetary process is not yet complete.

Firstly, the decision-making is not complete in substantive terms: the government indicates that for a number of important topics a (budgetary) proposal will only be made in the Budget Memorandum. This means there is no main decision-making moment, which would allow integral decisions to be taken regarding the state budget's revenue and expenditure. Secondly, in the existing process not all budgetary documents are sent to parliament at the same time as the Spring Memorandum. For example, the supplementary budgets, the details of the Tax Plan Package and the independent budgetary advice are published separately. Thirdly, the Spring Memorandum does not provide any link to the European Semester, including the country-specific recommendations.

The Advisory Division recommends that as of next year, the preparation and formulation of the Spring Memorandum be improved with regard to these three aspects and that it be included in the evaluation announced by the government. A modified budgetary process also requires the States General to assume their responsibility in relation to the process and the substance. The aim of the new Spring Memorandum is to communicate with the States General in a timely manner about the main elements of the proposed policy in the run-up to the Budget Memorandum.

The Advisory Division notes that to a large extent the Spring Memorandum does not comply with European fiscal rules. There is compliance with the (60%) debt criterion but the actual and structural deficit rules will be exceeded in 2022. The structural deficit rule will not be met in 2023 either. European fiscal rules serve to ensure the sustainability of a country's government debt and to promote equal distribution of the benefits and burden of government policy across generations. The government acknowledges the overshoot with regard to European fiscal rules and justifies it using the argument of urgent investments for the future. The Spring Memorandum lacks any further justification.

In the Spring Memorandum the financial policy arising from the Coalition Agreement is translated into the expenditure ceiling and the revenue framework. These serve as an anchor for this government term's budgetary policy. If a cyclical downturn occurs in conjunction with budgetary setbacks, the question is whether public finances have adequate buffers for the continued implementation of trend-based fiscal policy. Both this and the previous government have implemented expansionary fiscal policy. Moreover, the government has decided to use withdrawals from several funds to cover other short-term policy proposals. As a result, expenditure for long-term challenges risks being crowded out.

The limited buffers and shift in focus to the short term are all the more concerning given the considerable economic and budgetary risks. The Advisory Division realises this poses major challenges for the government. Also taking into account the significant challenges and ambitions for the future. The effects of the Covid-19 pandemic and the serious geopolitical tensions are resulting in rising inflation and an upward pressure on interest rates worldwide, combined with declining consumer confidence and increasing volatility on financial markets. There are also diverse policy proposals with budgetary consequences, on which the government still needs to decide.

Bearing this in mind, the Advisory Division recommends the government include a more detailed consideration in the Budget Memorandum regarding:

I. The cohesion between financial and socio-economic government policy, including the country-specific recommendations from the European Semester;
II. Debt sustainability for various (downturning) economic scenarios, partly in relation to European and national fiscal rules and the trend-based fiscal policy pursued;
III. The intergenerational sustainability of public finances in relation to broad prosperity.

A. ANALYSIS

1. Modified budgetary process

This government's first Spring Memorandum differs from previous Spring Memoranda. The Memorandum not only addresses budgetary changes in the current year, but also the main points of the decisions related to the 2023 budget and it outlines a multi-year scenario of expenditure and the main points associated with revenue.

With the current government taking office, and on the advice of the 16th Study Group on Fiscal Policy, not only the main points of the expenditure side of the budget are decided in the spring, but also those on the tax side. This promotes the integrality of budgetary decision-making and affords the main decision-making moment in the spring even greater importance. Previously, the main decision-making moment was considered an internal cabinet meeting. This meant that parliament only obtained an insight into the budgetary decision-making process on Budget Day.

In its opinion on the Budget Memorandum 2022, the Advisory Division provided recommendations to parliament for reinforcing its rights associated with the budget.[2] The Advisory Division proposed, among other things, that from now on, the main decisions on the subsequent fiscal year 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 placed to act in a more timely manner. The government proposed several options for modifying the budgetary process to the House of Representatives.[3] It included the preference for the introduction of a multi-year Spring Memorandum.

This Spring Memorandum is a first step towards a new budgetary process. Compared with previous Spring Memoranda, this Memorandum contains the outcomes of the spring decision-making process, namely decisions relating to the main points on expenditure and revenue for the subsequent fiscal year. The Advisory Division views this as a positive development. At the same time, the Advisory Division finds that this process is not yet complete. Although the intention is to take integral decisions in the spring on the expenditure and tax side, the Advisory Division notes that the government has shifted a number of topics, especially (but not exclusively) on the tax side, to the next Budget Memorandum. This does not actually constitute a single, integral decision-making moment.

Modifications to the budgetary process also have an impact on the Tax Plan package. The government proposed announcing the contents of the Tax Plan package earlier by means of a letter in the spring. However, the provision of information related to the Tax Plan package in the current Spring Memorandum is limited, making it unclear which process the government will adopt. Precisely because the States General find the establishment of the Tax Plan package a rather tight process, the Advisory Division deems it preferable for both the Senate and the House of Representatives to be properly involved in the planning and the provision of information about the Tax Plan package and other fiscal legislation spread throughout the year.

A modified budgetary process requires all stakeholders to adapt, including the House of Representatives. The latter is given scope ex-ante to exercise its rights associated with the budget with regard to the main points, with the aim of having more time to debate the budgets and the Tax Plan package. This requires meticulous preparation by the government and the House. Publication of the Spring Memorandum well before 1 June, and bringing forward the Spring Memorandum debate in the House of Representatives could put it under pressure. It has been agreed that from now on the government will present the draft Spring Memorandum, as it does the draft Stability Programme and draft Budget Memorandum, to the Advisory Division, as the independent budgetary monitoring institute, before it finalises them and sends them to the Senate and the House of Representatives.

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2 Parliamentary Documents II 2021/22, 35925, No. 3.
3 Parliamentary Documents II 2021/22, Letter to Parliament on the Budgetary Process, April 2022.

Lastly, the Advisory Division notes that the Spring Memorandum is not aligned to the process of the European Semester. The Advisory Division acknowledges there is some tension between the European Semester cycle and the national budgetary process. Country-specific recommendations are published by the European Commission at the end of May/early July as part of the Semester. The Council only finalises the country-specific recommendations in July. The fact that the national and European cycles are not aligned has an effect on the European Commission and, in this case, the Dutch government. In its recent guidance, the Advisory Division already pointed out the usefulness of considering not only European fiscal rules but also the process, namely the European Semester, as part of the evaluation of the Stability and Growth Pact.[4]

The country-specific recommendations contain policy recommendations related to stimulating employment and growth while maintaining sound public finances. They thus constitute an essential component for boosting economic growth and convergence of the euro area as a whole. Therefore, the Advisory Division advises the government to explicitly address the country-specific recommendations in relation to financial and socio-economic policy in the Budget Memorandum and to indicate whether it intends to implement the recommendations and, as of next year, to reflect on the progress of the implementation of the recommendations from the previous year in the Spring Memorandum.

More generally, the cohesion between the Stability Programme and the Reform Programme, elements of the European Semester, must be enhanced with national fiscal policy and socio-economic policy.

Country-specific recommendations for the Netherlands 2022-2023

As part of the European Semester, in May 2022, the European Commission proposed country-specific recommendations and issued an overarching communication with regard to the Netherlands. These recommendations are not final until they have been discussed in the Council by representatives of the national governments, ratified by EU leaders during a summit in June and are formally established by the joint meeting of national finance ministers in July. In its recommendations the Commission proposes that the Netherlands take action in 2022-2023 with regard to the following topics:

1. By 2023, ensure that the growth of nationally financed current expenditure is in line with a broadly neutral policy stance, taking into account continued temporary and targeted support for households and businesses most vulnerable to increases in energy prices and to people fleeing Ukraine.
2. Increase public investment in the green and digital transition and energy security, including by using the Recovery and Resilience Facility, RePowerEU and other EU funds.
3. Reduce distortions on the housing market, including by taking measures to increase the supply of housing.
4. Adopt and implement the proposed pension system reform.

4 Parliamentary Documents 2021/22, 35924, No. 146.

5. Promote adequate social protection for the self-employed who do not have any employees, tackle false self-employment and reduce incentives for flexible or temporary contracts.
6. Address labour and skills shortages, in particular in the healthcare, education, digital and technical jobs and construction sectors, including by tapping into the underutilised labour potential resulting from the high share of part-time work and the lower employment rate of people with a migrant background.
7. Reduce overall dependence on fossil fuels by accelerating the roll-out of renewable energy, notably by further streamlining additional investments in grid infrastructure and permit procedures, improving energy efficiency (in particular of buildings) and accelerating investments in sustainable transport and agriculture.

2. Macroeconomic and budgetary context

2.1 Macroeconomic uncertainties

In the March 2022 Central Economic Plan (CEP), the CPB Netherlands Bureau for Economic Policy Analysis stated that the uncertainty caused by the war in Ukraine dominates the economic forecast.[5] Energy prices and inflation were rising even before the start of the war in Ukraine due to bottlenecks on the supply side of the economy. With regard to the Netherlands, the CPB Netherlands Bureau for Economic Policy Analysis identified even higher energy prices and thus even higher inflation as the main economic consequence of the war in Ukraine. The Dutch economy is relatively sensitive to the price of gas, partly because of its large food and commodity sectors.

On 23 May 2022, the European Commission published its 2022 Spring Economic Forecast as part of the European Semester.[6] In the Spring Forecast, the Commission presents a multi-year economic and budgetary projection for the euro area (at least year t+2). The Commission also discusses the economic outlook for individual Member States. Compared to the CPB's CEP forecast, the Commission expects a downward adjustment of GDP growth (see Table 1).

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

6 European Commission (2022) European Economic Forecast. Spring 2022.

Table 1: Key figures of macroeconomic developments

(changes in % per year, unless specified otherwise)	2022 CPB Forecast, March	2022 Spring Forecast (May)	2023 CPB Forecast, March	2023 Spring Forecast (May)
The Netherlands				
Gross Domestic Product	3.6	3.3	1.7	1.6
Exports of goods and services	4.9	3.9	4.3	3.5
Imports of goods and services	5.5	4.1	5.5	4.3
Inflation (HICP)	5.9	7.4	2.2	2.7
Unemployed working population (level)	4.0	4.0	4.3	4.2
EMU balance (level in % of GDP)	-2.5	-2.7	-2.3	-2.1

The Commission states that the Dutch economy has strong foundations, but foresees headwinds in the short term. Rising gas and energy prices have a major impact on Dutch inflation figures. The Commission estimates Dutch inflation at 7.4% in 2022 and expects household consumption to be hit by rising commodity prices. Corporate investments are under pressure due to the economic uncertainties caused by the war in Ukraine, the (very) tight labour market and persistent problems with supply chains caused by new Covid-19 lockdowns in China.

The rest of Europe also faces economic headwinds. The energy market is an unpredictable factor. There are several potential scenarios ranging from long-term higher energy and raw material prices to a possible reduction in gas supplies from Russia. Developments on the energy market may have a negative impact on the economic growth of the entire euro area and lead to higher rates of inflation. In addition, these risks may spill over on to other markets such as energy-intensive agriculture, with possible increases in food prices.[7]

The CPB argues that the Covid-19 crisis and the war in Ukraine have led to increased volatility on financial markets, with potential spillovers on to both the financial sector and the real economy.[8] Rising interest rates could lead to financial risks, including on the housing market. Moreover, the possibility of a new Covid-19 crisis should be taken into account. A resurgence of the virus may lead to disruptions in world trade and supply chains resulting in increased inflationary pressure. The combination of these factors results in an uncertain economic outlook.

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[7] European Commission (2022). European Economic Forecast. Spring 2022, page 49.

[8] CPB Netherlands Bureau for Economic Policy Analysis (2022). Financial Markets Risk Report 2022, page 22.

2.2 Budgetary uncertainties

The Spring Memorandum was published against the background of these economic risks. Compared to the Stability Programme, the Spring Memorandum contains further details of budgetary agreements in the Coalition Agreement and additional decision-making. This provides an update of the budgetary information compared to the Stability Programme. Both the Stability Programme and the Spring Memorandum are based on the CPB's CEP forecast, the assumptions of which have become more uncertain due to the economic developments and the developments in the war in Ukraine since early March. However, an update of the macroeconomic figures will not be available until the publication of the Draft Macroeconomic Outlook (draft MEV) in August 2022. After publication of the Budget Memorandum 2023, a more complete picture will be provided by the Macro Economic Outlook, including the August decision-making process.

In the April Report 2022, the Advisory Division advised that greater macroeconomic uncertainties be taken into account in the Spring Memorandum and asked the government to explain how it will address any unfavourable (economic) developments in relation to its budgetary rules.[9] In the Spring Memorandum the government states that it is a turbulent time with many uncertainties. The government does not discuss the possible budgetary implications. However, economic uncertainties have increased rather than decreased. The Advisory Division recommends that the Budget Memorandum devote attention to various economic scenarios and the possible consequences of the scenarios for the budget and debt sustainability in particular.

2.3 The budgetary outlook

As previously mentioned, the Spring Memorandum provides an initial budgetary outlook of the consequences of the intentions specified in the Coalition Agreement and the spring decision-making process. This results in an adjustment of the estimates for the fiscal targets prepared by the Ministry of Finance (see Table 2). The actual and structural EMU balance has been adjusted downward compared to the Budget Memorandum and the Stability Programme. Since the Budget Memorandum, estimated government revenue has increased, but less than expenditure. The increased expenditure is caused by additional expenditure arising from the Coalition Agreement, decisions related to expenditure in the Spring Memorandum and the increased wage and price development.

The estimated structural deficit is greater than the actual budget deficit because the government's expansionary fiscal policy is being implemented during a period in which economic growth is higher than the economic trend growth. The estimated debt has been revised downwards, due to lower than projected debt in 2021 and higher projected nominal GDP, partly caused by high inflation. The latter is the so-called denominator effect: with higher nominal GDP (i.e. not adjusted for inflation) and a slower increase in debt, the debt ratio (which is measured in

[9] Parliamentary Documents II 2021/22, 21501-07, No. 1840, page 4.

relation to GDP) automatically decreases. The review under the European budgetary rules is provided in Section three of this report.

Table 2: Key figures of public finances

	2022			2023	
(changes in % of GDP per year)	**2022 Budget Memorandum**	**CEP**	**Spring Memorandum**	**CEP**	**Spring Memorandum**
Actual EMU balance	-2.3	-2.5	-3.4	-2.3	-2.5
Structural EMU balance	-2.6	-3.0	-3.9	-2.8	-3.1
EMU debt	56.5	53.8	52.9	53.1	53.2

2.4 Comply or explain

In the April Report 2022, the Advisory Division notes the government's statement in the Stability Programme that "the sustainability of public finances is not jeopardised in the medium term", was insufficiently substantiated. The Advisory Division recommended justifying this position by indicating in the Spring Memorandum how the government will address 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 (see Table 2).

The structural balance is the budget deficit adjusted for cyclical influences and offers an insight into the sustainability of public finances in the medium term. A rising structural deficit implies that the budget will be even more out of balance in the medium term. This will mean a deterioration of public finances in the medium term. The Advisory Division is aware that, as part of the review of the Stability and Growth Pact, the question of whether the structural balance should remain one of the European variables in fiscal policy will be addressed. Apart from this outcome, the notion of a fair distribution of financial benefits and burdens across generations that underlies sustainable public finances is widely supported in the Netherlands from the perspective of broad prosperity.

In the Spring Memorandum, the government states that it deems the risk of a temporary deterioration in public finances acceptable in view of the urgency of investments in the areas of climate, nitrogen, education and innovation. At the same time, it recognises that there is some tension with regard to European fiscal targets. The government expects the deterioration of the structural balance to be temporary, due to the incidental nature of most investments. Spending may also lead to a higher GDP in the future, which, due to the denominator effect, leads to lower balances.

The Advisory Division notes that the government still does not provide justification (explain), let alone complies (comply). The Advisory Division acknowledges the urgency of investments in the areas specified by the government. At the same time, the actual (timely) implementation of the plans is challenging due to bottlenecks in implementation, on the labour market and those related to the supply of goods and materials. In the CEP forecast the CPB already assumed underutilisation of expenditure on education, defence and the National Growth Fund.[10] Delays in implementing the plan and/or underutilisation may lead to higher expenditure at a later date. It is important to identify and take into account potential bottlenecks and other implementation effects early on in the planning process in order to strengthen the policy-making chain. The social tasks and formulated goals still apply in full.

The government considers most investments to be incidental, so the deterioration of the structural balance would be temporary. However, the fact that the investments do not lead to structural financing is not evident in all cases. Therefore, in its analysis of the Coalition Agreement the CPB assumed that policies that are not by their nature incidental will be financed structurally.[11] The underlying measures, which are yet to be presented, should show whether the expenditure is in fact incidental or not.

Moreover, in the Spring Memorandum the government has decided to use withdrawals from several funds to cover other short-term policy proposals. As a result, expenditure for long-term challenges risks being crowded out. The government states that the climate and nitrogen targets will remain intact: instead of investments, additional norm setting agreements are proposed. However, these have not yet been elaborated. The fact that the planned investments will lead to higher GDP is also not a given.

The Advisory Division reiterates its advice to devote attention to medium-term sustainability of public finances in relation to broad prosperity, now, in the Budget Memorandum. Bridging the high structural deficit to a lower, more sustainable (and certainly not primary) level should not be understood as an incentive for cutting spending and/or increasing taxes. Sustainable, and thus intergenerationally fair, public finances from the perspective of broad prosperity are primarily promoted by good social security and labour market, education, healthcare, housing and taxation, energy and climate systems. This is the way to sustainably strengthen the economy and public finances. This is also how the European Commission's country-specific recommendations should be understood. The Coalition Agreement does not yet contain any detailed or initiated intentions in these areas.

2.5 Limits are in sight

In the Spring Memorandum the government states that the limit of expenditure the government considers acceptable has been reached. In the Spring Memorandum the financial policy arising from the Coalition Agreement is translated into the

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[10] CPB Netherlands Bureau for Economic Policy Analysis (2022). Central Economic Plan 2022. CPB forecast, March 2022, page 32.

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

budgetary frameworks: the expenditure ceiling and the revenue framework. This means that, in principle, coverage will have to be provided for new policies with budgetary implications (see also Section B4.1). The translation of the frameworks into fiscal targets (see Table 2) shows that by 2022, the budget deficit is expected to exceed the 3% deficit rule. This is against the background of several downward economic risks with potential implications for fiscal targets.

The government has thus pushed the limits of the budgetary margin. There are no more buffers to absorb any setbacks within the fiscal rules, which means that cutbacks may come into the picture. In addition, the likely underutilisation of budgets in general and of investments (and investment funds) in particular in the first half of the government term will have to be made up in later years. There is a danger of short-term issues crowding out long-term challenges and a risk of pro-cyclical fiscal policies.

3. Assessment under European fiscal rules

The Spring Memorandum provides an update to the budgetary information in relation to the Stability Programme, as explained in Section B2.4. It should be noted that the budgetary information in the Spring Memorandum is based on the models of the Ministry of Finance and has not been recalculated by the CPB Netherlands Bureau for Economic Policy Analysis. The publication of the Budget Memorandum in September is accompanied by that of the CPB's Macro Economic Outlook (MEV), which contains an update of the forecasts.

Table 3: Key figures of public finances

	2022		**2023**	
(changes in % of GDP per year)	**CEP**	**Spring Memorandum**	**CEP**	**Spring Memorandum**
Actual EMU balance	-2.5	-3.4	-2.3	-2.5
Maximum actual EMU balance	*-3.0*	*-3.0*	*-3.0*	*-3.0*
Structural EMU balance	-3.0	-3.9	-2.8	-3.1
Medium-term objective for the structural EMU balance	*-0.5*	*-0.5*	*-0.75*	*-0.75*
EMU debt	53.8	52.9	53.1	53.2
Maximum EMU debt	*60*	*60*	*60*	*60*

Sources: CPB Netherlands Bureau for Economic Policy Analysis, Detailed Central Economic Plan 2022; Spring Memorandum 2022

In the Stability Programme, the Netherlands has indicated that it will opt for a medium-term objective (MTO) for the structural balance of -0.75% of GDP from 2023 onwards. In 2022, an MTO of a maximum of -0.5% of GDP still applies. Member States with a structural balance worse than the MTO must comply with the expenditure rule. The Netherlands did not comply with this rule in April 2022 for both 2022 and 2023.[12] The Spring Memorandum did not assess the expenditure rule of the preventive arm of the Stability and Growth Pact (SGP), so a complete picture will only be available in the Budget Memorandum.[13]

Compared to the Stability Programme, which is based on the CEP forecast, both the actual and structural EMU balance deteriorated for 2022 and 2023 (see Table 1). EMU debt is lower than previously estimated. These budgetary figures mean that the Netherlands' budget for 2022 does not comply with the rules of the actual or structural EMU balance. As a result, in 2022, the budget does not comply with the rules of the corrective or preventive arm of the SGP. In 2023, the Dutch budget is expected to comply with the rules of the corrective arm of the SGP, but not with the rules of the preventive arm.

During the Covid-19 crisis, violations of the rules in the corrective arm did not result in any excessive deficit procedures being opened.[14] In the spring of 2023, the European Commission will consider whether to reintroduce proposals for opening excessive deficit procedures based on the budgetary results in 2022.[15] Therefore, an overshoot of the EMU balance rule in 2022 remains without consequences for now, but that will not necessarily be the case if there is another overshoot of the rules in 2023. In all cases, it is important to closely monitor development of the balance in 2022.

Due to the Covid-19 crisis, in March 2020, the European Commission activated the SGP's general escape clause, affording Member States maximum flexibility

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[12] Parliamentary Documents II 2021/22, 21501-07, No. 1840, page 15.

[13] The SGP consists of a corrective and a preventive arm. 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. For the Netherlands the MTO is -0.5% of GDP in 2022 and -0.75% of GDP in 2023. 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 in 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.

[14] The excessive deficit procedure relates to the corrective arm of the SGP. The European Commission may make a recommendation to the European Council to open an excessive deficit procedure. Member States in this procedure may be subject to sanctions to reduce excessive deficits.

[15] European Commission, 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 on the 2022 European Semester, Spring Package (2022) COM (2022) 600 final, page 13.

within the SGP to make additional fiscal efforts.[16] Before the start of the Covid-19 crisis, the Netherlands was in the preventive arm of the SGP. 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.

In the European Commission's recently published Spring Package, as part of the European Semester, it was decided to extend the application of the general escape clause up to and including 2023, due to the economic consequences and uncertainties arising from the war in Ukraine.[17]

Therefore, the overshoots in the preventive arm of the SGP have no consequences for 2022 and 2023 due to the active general escape clause. The Advisory Division notes that the sustainability of public finances must not be jeopardised in the medium term. The fiscal targets in the preventive arm provide insight into the medium-term sustainability of public finances.

As argued in the April 2022 Report, the sustainability of public finances is not a clear-cut concept and therefore not easy to answer with a yes or a no.[18] The expected failure to comply with the MTO and the expenditure rule in 2022 and 2023 will cause the sustainability of public finances to deteriorate. Combined with a worsened sustainability balance due to the Coalition Agreement,[19] an expected EMU debt of 61.0% of GDP in 2030,[20] rising interest rates and major downward economic risks (see also Section 5), it is important to continue monitoring the various indicators that may point to a deterioration in the sustainability of public finances (see also Section B2.4).

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[16] 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.

[17] European Commission, 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 on the 2022 European Semester, Spring Package (2022) COM (2022) 600 final, pages 12-14.

[18] Parliamentary Documents II 2021/22, 21501-07, No. 1840, pages 16-18.

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

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

4. Assessment under national fiscal rules

4.1. An anchor for fiscal policy.

The Initial Policy Memorandum and the Spring Memorandum emphasise the government's pursuit of trend-based fiscal policy. On the expenditure side, multi-year expenditure frameworks are established, each with an annual expenditure ceiling that may not be exceeded. On the revenue side a revenue framework applies with automatic stabilisation, as a result of which revenue windfalls benefit the government balance, revenue shortfalls burden the government balance. In this way, revenue moves in tandem, as it were, with the business cycle. The Spring Memorandum establishes the expenditure ceiling and the revenue framework for the entire government term. In principle, these frameworks are adjusted during the government term, which means that the frameworks set de facto policy-based upper limits for public finances. In the Spring Memorandum the government states that the frameworks thus serve as an anchor for this government term's budgetary policy.

In successive opinions, the Advisory Division has advised that, in order to promote both sustainable public finances and democratic decision-making, fiscal policy should be determined in a transparent manner, by specifying budgetary anchors for fiscal policy. However, the government's Initial Policy Memorandum lacked a clearly defined control variable on the basis of which integral decisions about raising taxes and spending collective resources could be made for this government term.

On this matter, in its letter of January 2022 containing recommendations for fiscal policy, bearing in mind Dutch and European fiscal rules, the Advisory Division recommended that the government make it clear which medium-term anchor(s) will be used and how they will be designed, in the Spring Memorandum.[21] Specifying the anchors used and why the budgetary situation is not only the outcome of policy, makes the budgetary situation part of policy considerations.[22]

The establishment of the frameworks, and thus the policy-based limitation of public finances, depends on the discipline of both the government and parliament to respect and enforce the frameworks during the government term. Only then can the budget contribute to economic stabilisation. Only exceptional circumstances can justify allowing policy interventions outside the regular budgetary processes and outside the multi-year frameworks. In the (not so distant) past, especially on the expenditure side, the frameworks were regularly breached during the government term without the occurrence of any exceptional circumstances.

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[21] Parliamentary Documents II 2021/22, 35788, No. C, page 3.
[22] Parliamentary Documents II 2021/22, 21501-07, No. 1840, page 16.

The Dutch budget has a high degree of budgetary elasticity. This means that it is relatively strong in its response to economic shocks. By pursuing a trend-based fiscal policy, the budget, in principle, moves in tandem with the business cycle. However, the decision to establish the level of the budgetary frameworks at the beginning of a government term is a political choice. The structural budget deficit is greater than the EMU balance during this government term. This implies expansionary fiscal policy. If a cyclical downturn occurs, the question is whether adequate buffers have been built-up for the continued implementation of trend-based fiscal policy.

In its input regarding the evaluation of the Stability and Growth Pact, the government states that it attaches importance to maintaining the 3% deficit rule and the 60% debt criterion. The government also says it wants to focus on improving enforcement and is highly committed to the sustainability of public finances in Member States.[23] With this in mind, a well-balanced budgetary anchor for Dutch public finances, which we also maintain, is all the more important.

4.2. Separation of revenue and expenditure

Orderly decision-making constitutes one of the basic principles of fiscal policy. As mentioned in Section 1, a single main decision-making moment for both the expenditure and the tax side of the budget contributes to this. An important national fiscal rule is the separation of revenue and expenditure; as an element of the so-called Zalm norm. This means that windfalls on the revenue side may not be used for additional expenditure, but also that revenue setbacks do not have to be offset by cuts on the expenditure side. Moreover, setbacks on the expenditure side must be compensated within the expenditure framework and must not lead to new measures on the revenue side. This provides maximum scope for automatic stabilisation and avoids pro-cyclical fiscal policy.

The separation of revenue and expenditure is not respected by the government in various policy cases, thus violating its own fiscal rules. Part of the additional expenditure from the purchasing power package of measures 2022 (energy allowance for municipalities) is covered on the tax side, the reduction in VAT on energy and the reduction in duty on petrol and diesel (tax side) are covered by a windfall in gas revenue on the expenditure side. The effect of the policy decision not to levy recovery interest on receivables from allowances that have not yet begun and on receivables for which a payment arrangement has been agreed constitutes a loss in the healthcare allowance. This loss falls under the revenue framework and is covered on the expenditure side.[24]

5. <u>Financing for local and regional authorities</u>

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[23] Parliamentary Documents II 2021/22, 21501-07, No. 1815.
[24] Parliamentary Documents II 2021/22, 36120, No. 1, page 24, page 32 and page 35.

In the letter containing recommendations related to fiscal policy of January 2022, the Advisory Division notes that the existing financing system for local and regional authorities and the additional measures included in the Coalition Agreement result in an unstable, complex and not particularly transparent multi-year budget for local and regional authorities.[25] In addition to this, the Advisory Division advised the government not to wait until the next government term to introduce a more stable financing system for local and regional authorities, but to compile a multi-year budgetary framework for local and regional authorities this spring, to replace the current accrual system. In the April 2022 Report, the Advisory Division asked the government to 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.[26]

In the Spring Memorandum, the government mentions a joint process with the Association of Netherlands Municipalities (VNG), Association of Provinces of the Netherlands (IPO) and the Dutch Water Authorities to arrive at a new financing system for local and regional authorities as of 2026. For the period up to and including 2025, talks are under way to freeze the volume component of the accrual, which should lead to more stable financing for local and regional authorities.

The (incoming) municipal executives are currently drafting or have already drafted their multi-year budgets following the municipal elections in March. However, the Advisory Division notes that there is no multi-year financial security yet for the coming years and for the period after 2025. As a result, municipalities can only plan ahead to a limited extent for major (physical) transitions in particular, and must take cost savings into account from 2026 onwards. It goes without saying that putting off the multi-year agreements to be made is not desirable from an administrative point of view and that it is therefore of great importance to conclude the aforementioned joint process with the local and regional authorities as soon as possible.

6. Tax liabilities and Covid-19

In the Spring Memorandum, the government presents an initial forecast of the payment capacity of companies based on an analysis of available profits. This forecast leads to a more negative adjustment of the repayment capacity as used in the Budget Memorandum. The total amount of depreciation of the outstanding debt is €7 billion. The analysis is still characterised by major uncertainties, such as the extent to which the available profit can actually be used to pay off debts. Nevertheless, the forecast is a first step towards identifying the extent of current and future debt problems.

[25] Parliamentary Documents II 2021/22, 35788, No. C, page 4.
[26] Parliamentary Documents II 2021/22, 21501-07, No. 1840, page 25.

In the April 2022 Report the Advisory Division recommended presenting a comprehensive picture of the scope and risks related to tax liabilities resulting from deferred payments during the Covid-19 crisis in the Spring Memorandum.[27] The Advisory Division underlines the government's statement to closely monitor the development of the outstanding tax debt.

7. Transparency

In its budgetary reports the Advisory Division reflects on the extent to which the government presents budgetary information in a transparent manner. Budgetary transparency is of great importance for a well-founded assessment of government policy by parliament and for creating support for policy in society. In the April 2022 Report the Advisory Division noted progress in the transparent presentation of budget-relevant topics.[28]

In the Spring Memorandum, the government demonstrates once again that it takes the transparent presentation of budgetary information seriously. The government provides insight into the multi-year horizontal (year-on-year) development of expenditure and taxes, as well as into the vertical changes in the budget, and into the development of total taxes and expenditure. In addition, the government presents the expenditure related to the war in Ukraine in a separate table. This has been the case for Covid-19-related expenditure for some time, following advice from the Advisory Division to present expenditure related to the Covid-19 pandemic and corresponding support measures separately.[29]

To conclude this June Report on the government's Spring Memorandum, the Advisory Division naturally expresses its willingness to provide you, and both the Senate and the House of Representatives, with a more detailed explanation. On the occasion of Budget Day, the Advisory Division will issue its independent budgetary report and its opinion on the Budget Memorandum.

The Vice-President of the Council of State,

[28] Parliamentary Documents II 2021/22, 21501-07, No. 1840, page 26.
[29] September 2020 Report, Parliamentary Documents II 2020/21, 35570, No. 3.