Meeting with the Netherlands' Ministry of Finance on the Dutch Fiscal Framework

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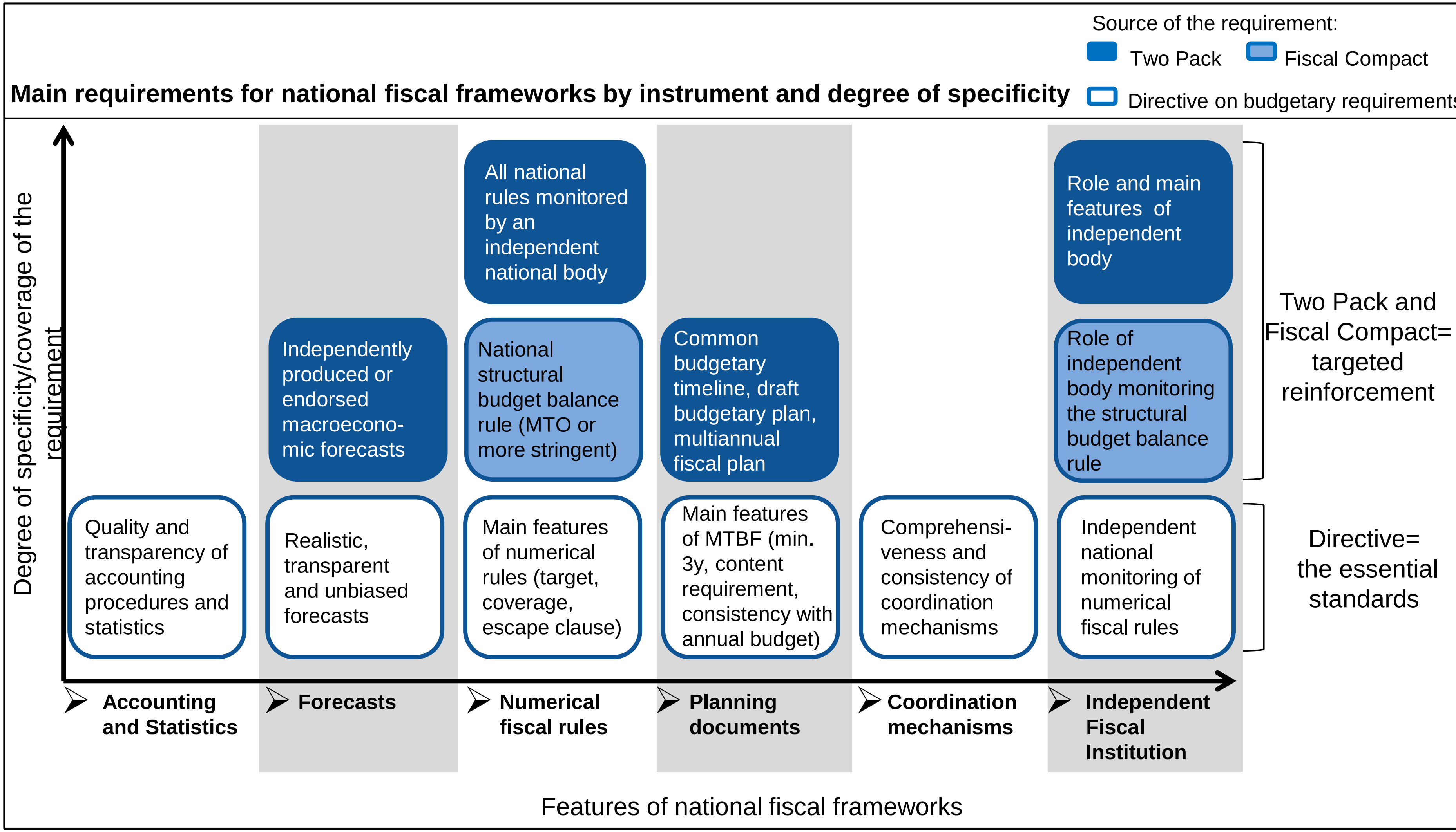
Objectives

1. Strenghtened requirements at EU level
2. Preliminary assessment of the Dutch fiscal framework
3. Lessons from European peers: the Swedish and Finnish examples
4. Potential options for improvement

1. Strenghtened requirements at EU level

Three supranational legal instruments are mutually reinforcing on the main features of budgetary frameworks



2. Preliminary assessment of the Dutch fiscal framework

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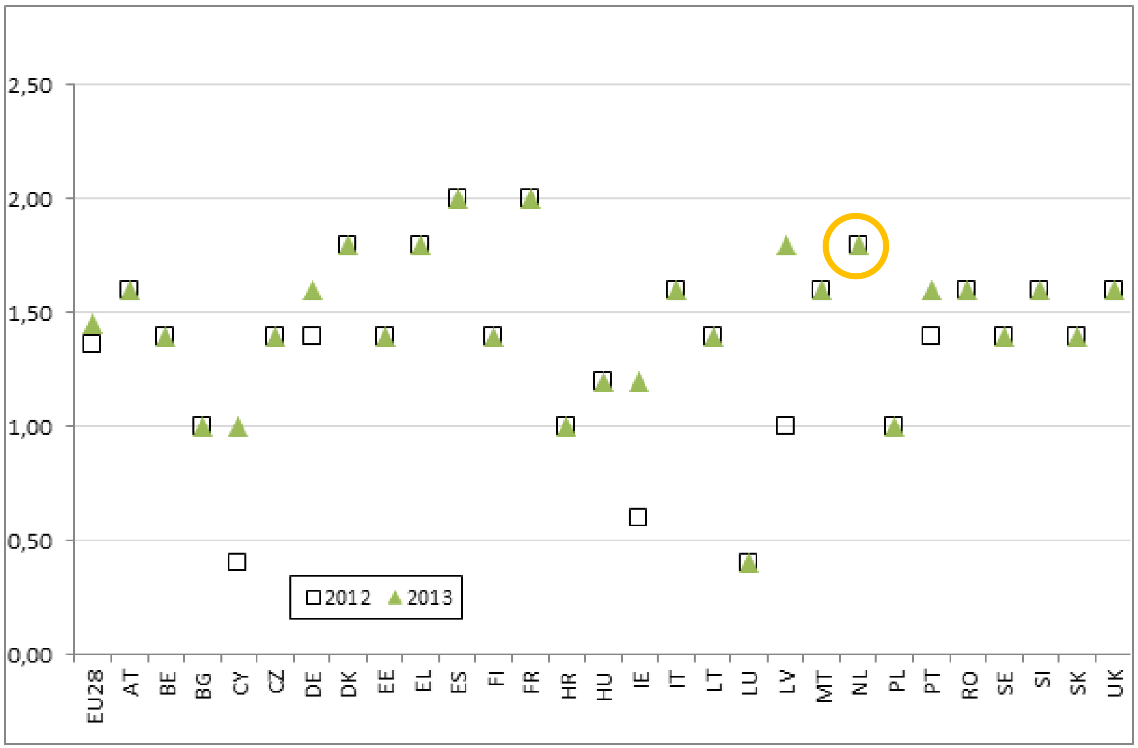
The Dutch framework supports trend-based budgeting

	Main features of the Dutch fiscal framework
Multiannual ceilings	▪ Binding real expenditure ceilings are set for the entire term of government and embedded in the coalition agreement. – Excluding interest payments – Including other cyclical expenditures ▪ Automatic stabilisation takes place on the revenue side: multiannual revenue ceilings are fixed for the coalition period.
Budget calendar	▪ Budgetary decision-making is focussed on two distinctive moments (expenditure adjustment every spring, revenue adjustment every autumn)
Macro forecasts	▪ Macroeconomic assumptions underpinning budgetary planning are independently produced by the CPB
Latests legislative developments	▪ The Wet HOF (Act on Sustainable finances of the public sector) adopted in December 2013: – Provides a legal basis for the trend-based policy – Constraints the trend-based policy by EU numerical fiscal rules: MTO, EMU balance ceiling, EMU debt ceiling – Requests the Government to take corrective measures in case the Ministry of Finance or the EU establish that these fiscal rules are not complied with. The Advisory Division of the Council of State is mandated to monitor the progress of correction measures – Provisions penalties in case the outturn of decentralised public authorities' collective share in the budget balance exceeds the one set for the general government in line with EU requirements

The Dutch MTBF is one of the most advanced across the EU

MTBF index in the EU-28, 2012 and 2013 data

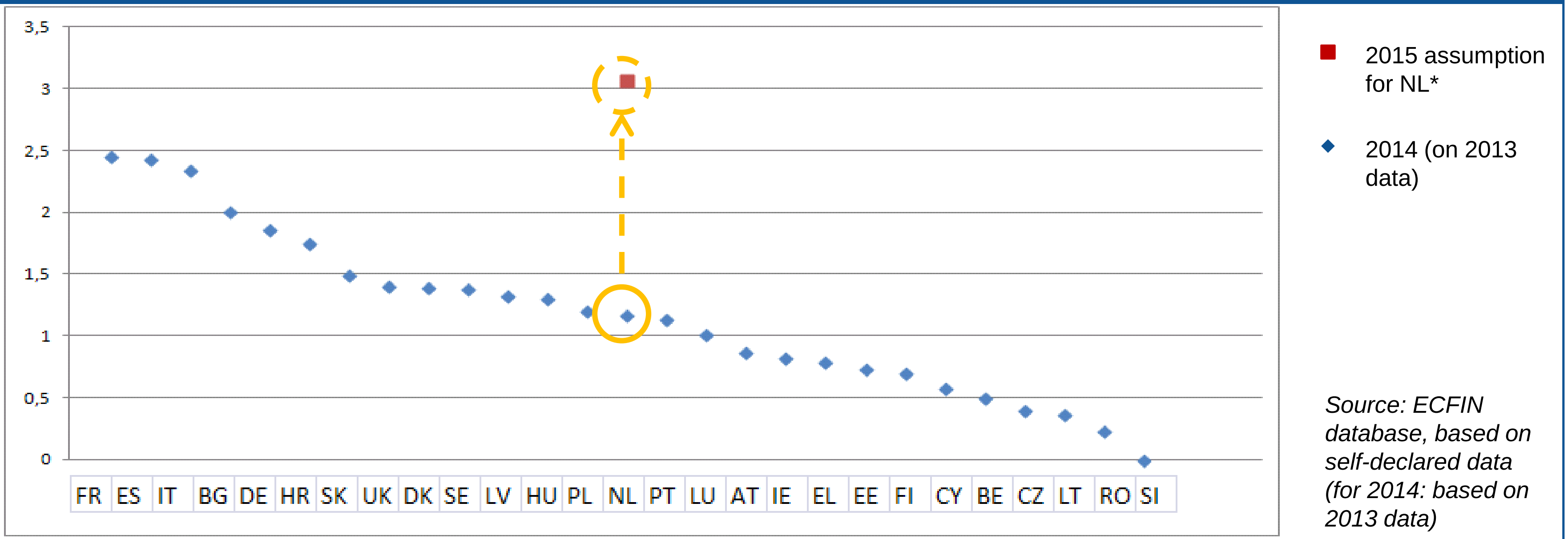


Source: ECFIN database, based on self-declared data

- **The advanced nature of the Dutch MTBF** as compared to its peers is confirmed – it is only topped by France and Spain whose legal provisions tend to be detailed.
- **The provisions from the Wet HOF are not counted in this update of the MTBF index**. They will be taken into account for the next update of the database.

The rules introduced by the Wet HOF may reposition the Netherlands in the fiscal rules index

Numerical fiscal rules index in the EU-28, 2014 (on 2013 data)*



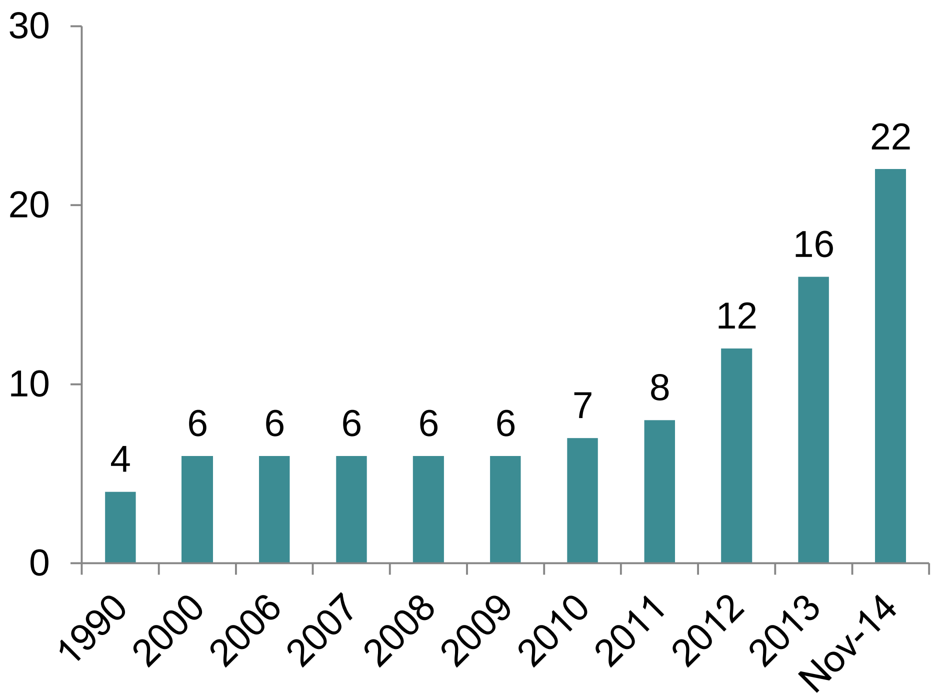
Source: ECFIN database, based on self-declared data (for 2014: based on 2013 data)

- In the 2014 update of the ECIN database (based on 2013 data, not including Wet HOF rules):
  - the Dutch expenditure and revenue ceilings' are currently positioned **in the middle segment**
  - The index on these rules could increase with real time monitoring with risk alert mechanism and escape clauses.
- At this stage, the methodology of the index focuses on **institutional setting and legal provisions** rather than on performance track record.
- According to a preliminary assumption, the index performance for the Netherlands may improve in the 2015 update when Wet HOF rules will be reported by Dutch authorities (the database is based on self-declared data by all EU-28).

* Adjusted, simplified methodology. This is a preliminary assumption.

The Netherlands stand out as an exception in the landscape of independent fiscal institutions

Evolution of the number of IFIs in the euro area



The Netherlands: an exception

With Austria and Belgium, the Netherlands are among the few euro area Member States which have two fiscal institutions:

- One "**Forecaster**" institution in charge of the production of the macro economic forecasts → the CPB
- One **"Validator"** institution, mostly in charge of assessing compliance of budget planning and execution with national fiscal rules → The Council of State

The crisis exposed tension points in the Dutch framework

Strenghts

- The central role in the budgetary process of a well-established and independent body, the CPB, whi provides – inter alia – macroeconomic assumptions underpinning budgetary planning
- The experience and trackrecord in trend-based multiannual budgeting
- The committment to agree on multiannual expenditure ceilings and comply with them over a coalition period

Tension points

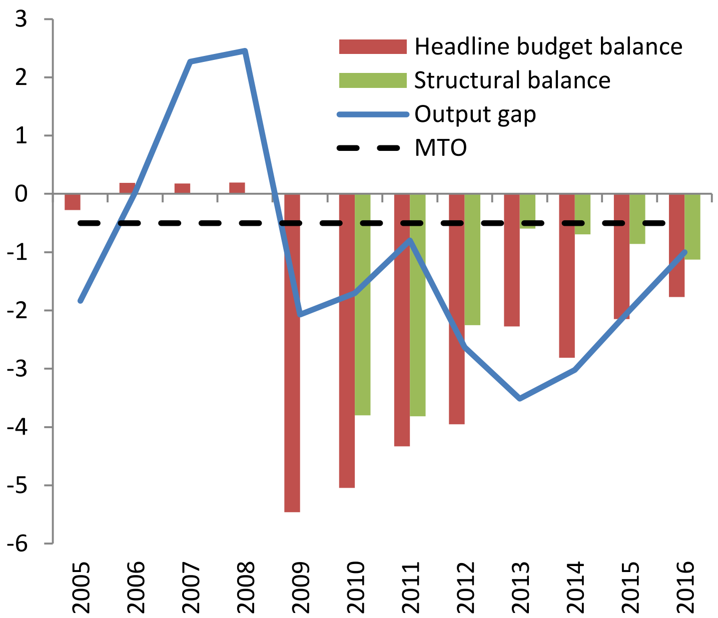
- Insufficient flexibility in case of macroeconomic instability, due to ceilings being fixed based on relatively high growth assumptions (with hindsight)
- Increased complexity in the definition of ceilings?
- Compatibility of the trend-based framework with renewed European budgetary committments

The Dutch fiscal framework is one of the more advanced in the EU.

A number of tension points were exposed by the exceptional circumstances of the crisis, during which the Netherlands were in EDP.

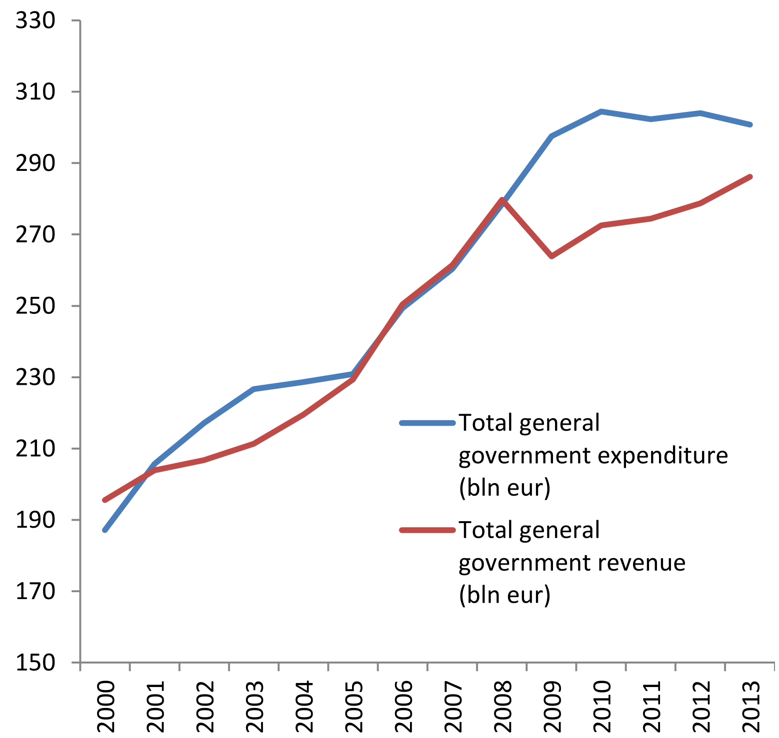
Tension points are reflected in excessive government deficits as expenditure exceeded revenues

General government balance and output gap, Netherlands, 2005-2016 (% GDP)



Note: Due to transition to ESA2010, the structural balance is only available as of 2010. Figures for 2015 and 2016 are forecasts. Source: European Commission.

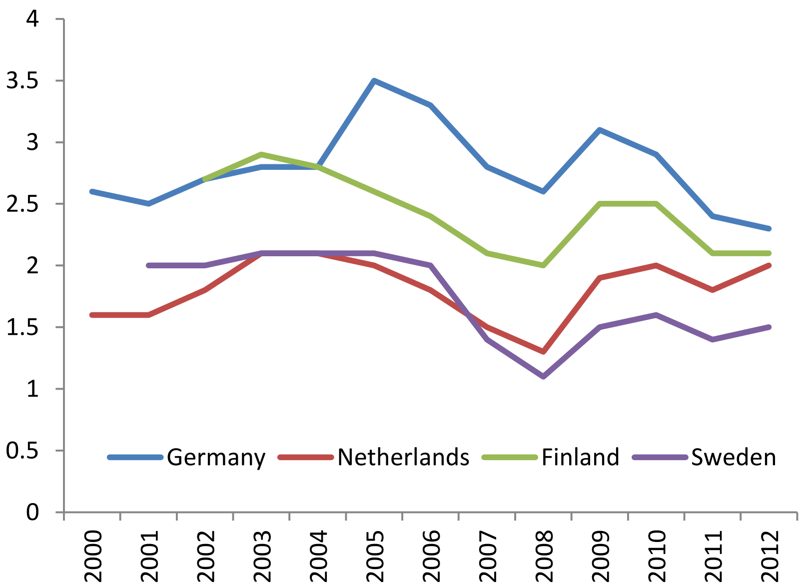
General government revenue and expenditure, Netherlands, 2000-2013 (current EUR)



Source: European Commission.

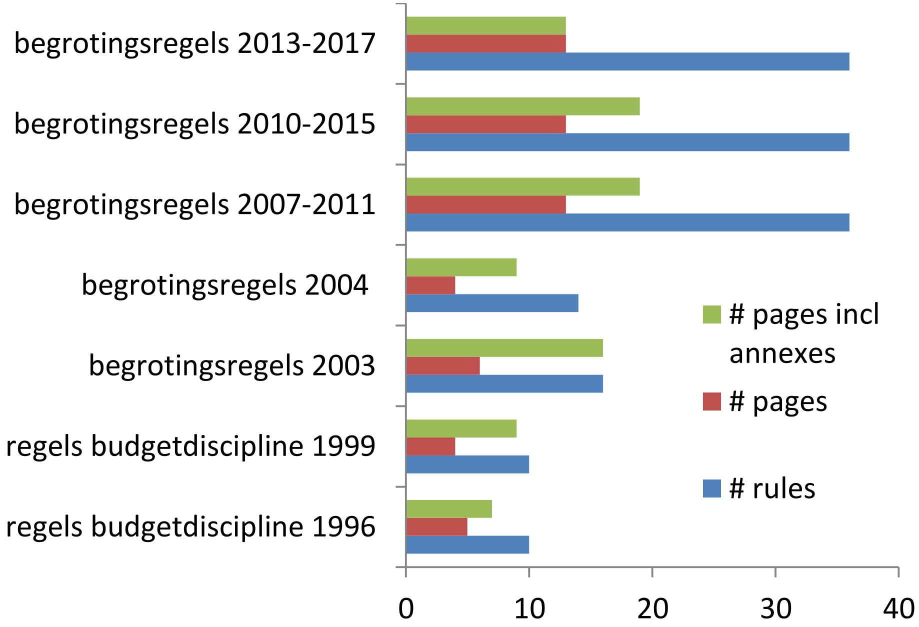
Government expenditure for unemployment on the rise while complexity of guidance increased

Unemployment expenditure of general government, 2000-2012 (% GDP)



Source: European Commission.

Budgetary guidelines, Netherlands, 1996-2017



Source: European Commission.

3. Lessons from European peers: the Swedish and Finnish examples

Comparison of the Dutch, Swedish and Finnish fiscal frameworks

Main difference in the NL framework

		The Netherlands	Sweden	Finland
1 Overarching numerical fiscal target/rule		To be confirmed • The structural-budget balance rule was recently introduced by the Wet HOF	• Surplus target of 1% of GDP for general government net lending over the cycle	• Nominal deficit of the central gov. cannot exceed 1% of GDP • Structural-budget-balance rule recently introduced or the GG
2 Expenditure ceilings	Ceilings	• Real expenditure ceilings converted annually in nominal terms	• Nominal expenditure ceilings fixed consistently with the 1% surplus target	• Real expenditure ceilings converted in nominal terms annually
	Duration	• 4 years (coalition period)	• 3 years	• 4 years (parliamentary term)
	Margin	No budgetary margin. No escape clause	• Budgetary margin below the ceilings. No escape clause.	• Budgetary margin below the ceilings
	Rainy Day Fund	• None	• None	• 2 rainy day funds (detail in annex)
	Cyclicality	Exclusion of interest payment	• Exclusion of interest payments of central govt debt, more recent inclusion of tax expenditures	• Cyclically-sensitive items are excluded
	Coverage	• General government	• Central govt. and pensions	• 80% of central government
3 National Fiscal Institutions with a production or monitoring role		The CPB (forecasts production) • The Council of State (monitoring role of the progress of the correction in case of deviation from the sBBR	• A Fiscal Council was established in 2007 to assess compliance with numerical fiscal rules and quality of budgeting.	• The Court of Auditors is in charge of monitoring compliance with fiscal rules and endorsing macroeconomic forecasts

4. Potential options for improvement

FOR DISCUSSION

Several reform options could be considered

Selection of reform options	Questions to address for each option
▪ A return to prudent growth forecasts? ▪ A reinforced focus on the MTO? ▪ The removal of cyclically-sensitive outlays from the multiannual expenditure ceilings? ▪ The definition of exceptional circumstances allowing for the revision of multiannual expenditure ceilings? ▪ The introduction of a budgetary buffer?	▪ How is the option contributing to the overarching budgetary objective that the Netherlands would like to prioritize? ▪ What is the budgetary value-added and risks versus the current framework? ▪ How does this option change the balance between budget control and flexibility? ▪ What is the implementation timing/ political likelihood/ social impact?

- The benefit of reforming the current framework in-depth to cater for exceptional circumstances versus introducing specific clauses for such circumstances should be carefully assessed

Annex

The Swedish framework was gradually overhauled after the national budgetary crisis of the 1990s

	Main features of the overhauled framework	Objective	Coverage
1 **Surplus fiscal rule**	• Surplus target of 1% of GDP for general government net lending over the cycle	• Ensure fiscal sustainability	• Whole general government sector
2 **Expenditure ceilings**	• Nominal expenditure ceilings fixed by Government and Parliament for 3 years, consistently with the 1% surplus target. • Addition of an outer year annually. • Break down on ~27 expenditure lines • Budgetary margin below the ceilings • Exclusion of interest payments of central govt debt, inclusion of tax expenditures	• Cope with past expenditure slippages • Support the surplus fiscal rule • Reduce pro-cyclicality	• Central government (~31% of total expenditure in 2013) • Pension system
3 **Local fiscal rule**	• Indirect budget balance rule for local governments: a deficit must be compensated by a surplus within 3 years • Possibility to accumulate reserves in good times to cover deficits during bad times	• Avoid slippages • Encourage counter-cyclical budgeting at local level	• Local governments (~25% of total expenditure in 2013)
4 **Fiscal Council**	• A Fiscal Council was established in 2007 to assess compliance with numerical fiscal rules and quality of budgeting.	• Strenghten compliance with budgetary and fiscal policy objectives	• Whole general government sector

The Finnish framework was reformed in 2003, following a major budget crisis in the 1990s

	Main features of the reformed framework	Coverage
1 **Fiscal rule**	• Nominal deficit cannot exceed 1% of GDP • Structural-budget-balance rule recently introduced with a view to transpose the Fiscal Compact	• Central government • General government
2 **Expenditure ceilings**	• Real expenditure ceilings set for the 4-year parliamentary term (converted in nominal terms annually for year t+1) • Cyclically-sensitive items are excluded • The ceilings include a budgetary margin, the supplementary budget provision, to deal with unexpected events	• 80% of Central government expenditure
3 **Local fiscal rule**	• Budget balance rule whereby in case deficit occur, it has to be offset by local governments within a 4-year period	• Local governments
4 **Rainy Day Funds**	• Since 1999, contingency reserves generated from fiscal surpluses are deposited in a stabilization fund, and can be withdrawn during bad times. • They are limited to unempolyment benefits and pensions to stabilise contribution rates in bad times.	• Unemployment benefits and pensions

- The current framework has been criticized in Finland due its lack of flexibility during the crisis (volatility in underlying macroconomic assumptions).
- As a result, flexibility was added by excluding cyclically-sensitive items from the expenditure side.

A typology of IFIs (I)

1. THE FORECASTERS

- Focus of mandate on forecast-related responsibilities
- Well-established institutions, with a longstanding reputation in forecasting
- Additional technical responsibilities included in the mandate
- Significant autonomy, supported more by expertise rather than by legal guarantees
- Staff size significant
- Recently included in the IFI population (since the Two-Pack)

For example:

- *WIFO in Austria*
- *CPB in the Netherlands*
- *Federal Planning Bureau in Belgium*

2. THE ENDORSERS

- Mandate restricted to ex-post compliance assessment with the structural budget balance rule
- Hosted within well-established institutions…
- … but with new responsibilities
- Benefit from host institution's resources to establish their independence …
- … but need for ring-fencing arrangements with host institutions (independence safeguards may be implicit only)
- Specialised staff limited in numbers

For example:

- *The Council of State in the Netherlands*
- *The Court of Auditors in Finland*
- *The Court of Auditors in Lithuania*

A typology of IFIs (II)

3. FISCAL COUNCILS

- Mandate encompasses multiple responsibilities related to public finances
- Mandate focuses on regular analyses of fiscal rules and policies
- Mandate often includes delivering an assessment of budgetary forecasts
- Staff of limited size, but composed of well-rounded economists
- Often detached Institutions
- Institutions recently created; the scope of their mandate being significantly influenced by EU requirements (6-Pack & 2-Pack)

For example:

- *'Irish Fiscal Advisory Council' (IFAC) in Ireland*
- *'Council for Budget Responsibility' in Slovakia*

4. ADVANCED FISCAL COUNCILS

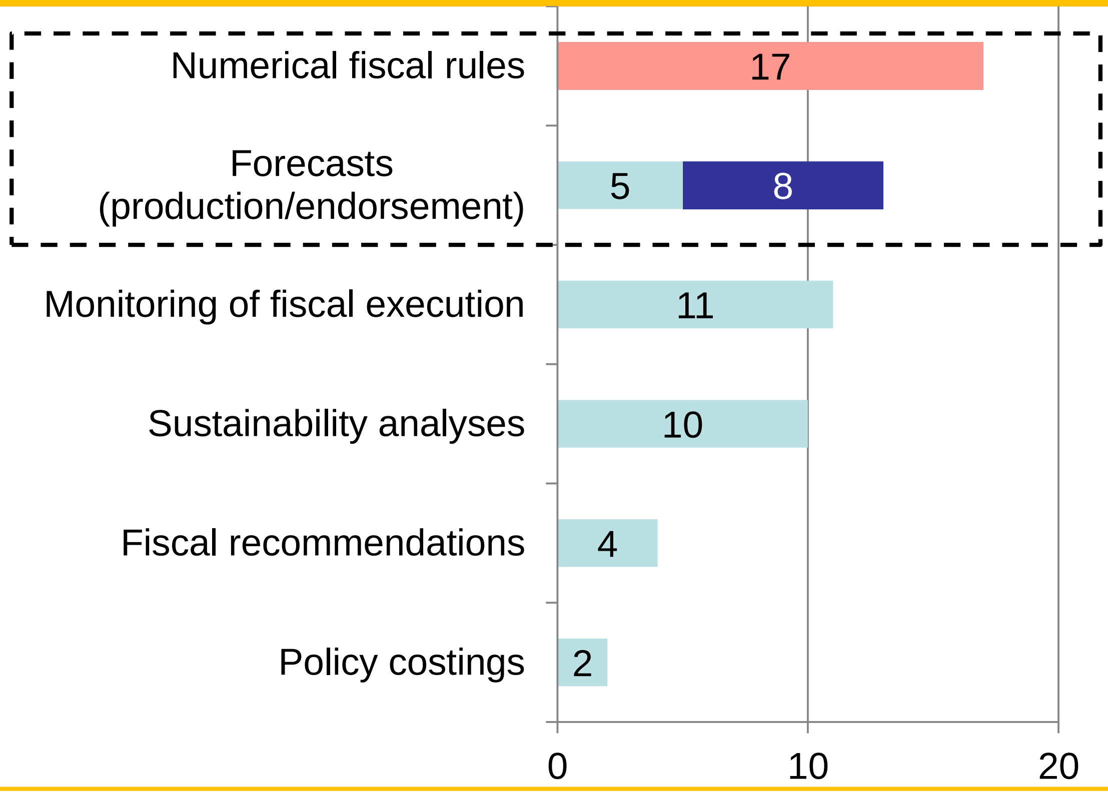
- Same features as the Fiscal Councils but …
- … extended mandate, beyond the 6-Pack and 2 Pack, including additional responsibilities (promotion of transparency, policy costing, monitoring of local, regional governments or SOEs in the fiscal area)
- … with larger staff
- Institutions created in Member States facing sizeable consolidation needs

For example:

- *The Council of Public Finances (CFP) in Portugal*
- *The Parliamentary Budget Office (UPB) in Italy*

IFIs in the euro area: overview of tasks

Tasks of IFIs in the euro area, number of IFIs concerned



IFIs are discharging a variety of tasks primarily focused on forecasting and fiscal rules

Independent Fiscal Institutions	Fiscal Rules	Forecasting	Other tasks
Austria – Fiskalrat	*X*		*X*
Austria – WIFO		*P*	
Belgium – Bureau Fédéral du Plan		*P*	*X*
Cyprus – Fiscal Council	*X*	*E*	
Estonia – Fiscal Council	*X*	*E*	
Finland – Court of Auditors	*X*		
France – Haut Conseil des Finances Publiques	*X*	*E*	
Germany – Unabhängiger Beirat	*X*		
Ireland – Irish Fiscal Advisory Council	*X*	*E*	
Italy – Ufficio Parlamentare di Bilancio	*X*	*E*	*X*
Latvia - Fiscal Discipline Council	*X*	*E*	*X*
Luxembourg – Conseil National des Finances Publiques	*X*		
Netherlands – Raad van State	*X*		
Netherlands – Centraal Planbureau		*P*	*X*
Portugal – Conselho das Financas Publicas	*X*	*E*	*X*
Slovakia – Council for Budget Responsibility	*X*	*E*	*X*
Slovenia – Institute of Macroeconomic Analysis and Development		*P*	
Spain - AIReF	*X*	*E*	*X*
Note: Fiscal Rules = TSCG sBBR & other domestic fiscal rules monitoring; P= production; E= endorsement.			

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Structure of IFIs: date of creation, leadership term and staffing

Independent Fiscal Institutions	Date of creation/reform (1)	Leadership Term	Board/Staff (2)
Austria – Fiskalrat	***1970/2013***	***4***	***12/2.5***
Austria – WIFO	***1927***	***5***	***16/100***
Belgium – Federal Planning Bureau	***1959***	***na***	***1/96***
Cyprus – Fiscal Council	***2014***	***6***	***3/2***
Estonia – Fiscal Council	***2014***	***5***	***6/0***
Finland – Court of Auditors	***1924/2012***	***6***	***na***
France – Haut Conseil des Finances Publiques	***2012***	***5***	***11/5***
Germany – Unabhängiger Beirat	***2014***	***5***	***9/0***
Ireland – Irish Fiscal Advisory Council	***2011/2013***	***4***	***5/5***
Italy – Ufficio Parlamentare di Bilancio	***2014***	***6***	***3/11***
Latvia - Fiscal Discipline Council	***2014***	***6***	***6/na***
Luxembourg – Conseil National des Finances Publiques	***2014***	***4***	***7/1***
Netherlands – Raad van State	***1531/2013***	***Life***	***10/na***
Netherlands – Centraal Planbureau	***1945***	***7***	***3/105***
Portugal – Conselho das Financas Publicas	***2011***	***7***	***5/22***
Slovakia – Council for Budget Responsibility	***2012***	***7***	***3/10***
Slovenia – Institute of Macroeconomic Analysis and Development	***1994***	***5***	***3/48***
Spain – AIReF	***2014***	***6***	***1/35***

Notes: (1) Date of creation followed by date of EU/TSCG-induced reforms; (2) Board or leading personnel /staff numbers