

THE DUTCH FISCAL FRAMEWORK AND THE ROLE OF THE CENTRAL PLANNING BUREAU

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According to the IMF and OECD, the Dutch fiscal framework is rather unique, and its design and implementation are highly recommendable. This paper describes this framework and the role of the CPB. Major features of the Dutch fiscal framework are the trend-based fiscal framework with real net expenditure ceilings for the whole term of government, the role of independent organisations, like the CPB, Statistics Netherlands and the Netherlands Court of Audit, and the intermediary role of the national advisory group on budgetary principles.

1 Introduction

For years, the IMF and OECD have been stressing the importance of national fiscal rules and institutions. They provided standards for good practice and gave overviews of best practice.¹ In the annual country reports by the IMF and OECD, the national fiscal frameworks are always discussed in view of these standards and best practices.

According to the IMF and OECD, the Dutch fiscal framework is in many respects unique and highly recommendable. This applies to e.g. the medium-term expenditure ceilings, the use of independent macroeconomic estimates in the budgetary process, the analyses and estimates by the CPB about Dutch public finance and the role of Statistics Netherlands, the Netherlands Court of Auditors and the national advisory group on budgetary principles.

At present, medium-term expenditure ceilings are only used in few countries, e.g. the USA, New Zealand, Finland, Sweden and the Netherlands. However, IMF and OECD regard such expenditure rules as a very effective and efficient tool for managing public finance. Anderson and Minarik (2006, pp. 193-94) even argue that expenditure rules are on balance superior to deficit-based rules, like the general government budget balance used by the EMU. Anderson and Minarik therefore advocate that the EMU-government deficit rules should be complemented by national expenditure rules.

According to Wyplosz (2002, p. 9), rules do not suffice for sound fiscal policy, because “they tend to be rigid and artificial (arbitrary debt or deficit limits, golden rules based on thin air and falsifiable accounts), which makes them ultimately impossible to defend in the face of public opinions”. Institutions are therefore essential for combining a credible commitment to long-run debt stability

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¹ IMF (2001a), IMF (2001b), IMF (2005), OECD (2002).

with sufficient short run flexibility. He discusses a constitutional approach (a limit on debt or deficit in the constitution like in the states of the US) and three approaches relying on independent outside institutions.

In the Netherlands, independent national institutions are also very important for fiscal policy. However, the Dutch approach is in several respects quite different from those discussed by Wyplosz. For example, the CPB work does not give explicit guidance on fiscal policy targets; this is the task of the national advisory group on budgetary principles. This national advisory group on budgetary principles is actually a mix of an inside and outside institution, as it includes representatives from the most involved Ministries and from independent expert institutions (CPB and the Central Bank).

This paper provides an overview of the Dutch fiscal framework and its role in managing public expenditure.² Attention is paid to the preparations for the next government (e.g. the analyses by the CPB of election platforms and coalition agreements) and the fiscal framework during the term of government (e.g. how are unexpected windfalls and setbacks and changes in political plans managed?).

In Bos (2007b), an overview is presented the history of the Dutch fiscal framework since 1814. This historical perspective is important for understanding the current framework:

- It shows that the current framework has a long and typically Dutch tradition. For example, since 1945 the CPB plays an important role as independent expert on economic and fiscal policy. This role fits well in the Dutch tradition of consultation and coalition governments.
- It illustrates the tensions between official fiscal rules, changing economic circumstances and political pressure; bookkeeping tricks can then help to circumvent official fiscal rules.
- It sheds light on the process of institutional learning, e.g. the failures and successes about how to manage rapidly increasing public expenditure and to organize cut-back management when necessary.
- It shows that some specific circumstances are much less unique than commonly thought, e.g. high public debt, stagnating economic growth and substantial temporary non-tax revenues (revenues from Indonesia, Marshall aid and natural gas revenues).
- It demonstrates the important role of changes in the opinions of politicians and economists; several times this amounted to old insights rediscovered or becoming relevant again.

² Alternative overviews are provided by IMF (2006), Postma (2006), Tijsseling and van Uden (2004) and Berdsen (2001).

2 Major principles of the current fiscal framework

Minister of Finance Zalm supplemented the European norms with a national policy of trend based budgeting. Since 1994, the major features of this policy³ are:

- Net real expenditure ceilings for the whole term of government (four years);
- One main decision-making moment a year;
- A focus on reducing public debt.

Furthermore, there are also some supplementary fiscal rules and principles:

- A monitor for the ex ante micro tax and social security burden. This monitor shows the expected changes in taxes and social security contributions in billion euros due to official changes in tariffs and regulations. Unlike the collective tax and social security burden, the monitor is not affected by non-policy factors, e.g. purely administrative changes, general changes in consumption patterns or changes in the labour participation of women.
- An investment fund mainly financed via 40 per cent of the natural gas revenues (FES-fund); the remainder of the natural gas revenues are to be used for debt reduction.
- A signal value for the general government deficit of 2 or 2.5 per cent of GDP. Surpassing this signal value implies that additional measures are to be taken and that the expenditure ceilings do not apply anymore. This may result in pro-cyclical policy.
- The use of incentives and cost/benefit analysis for reorganizing and controlling public expenditure.

The combination of cautious macroeconomic assumptions and a long-term real expenditure ceiling limits the risk of budgetary turmoil resulting from economic setbacks. On the income side of the budget automatic stabilizers are allowed to work freely.⁴ Income setbacks can be compensated for in the budget balance and do not immediately require intervention by reducing expenditure or increasing taxes. The introduction of one main decision-making moment a year was intended to create a more stable and less hectic budgetary decision-making process, as was the case in the time path approach for reducing deficit (1983-93, see Bos, 2007b).

The framework is set with reference to a target for the fiscal balance based on longer-term budgetary sustainability considerations. The CPB analyses of short-term, medium-term and long-term developments in Dutch public finance are the backbones of this framework.

³ Cautious macroeconomic assumptions was also a feature. However, since February, the new government has decided to prefer trend based estimates (see Bos, 2007b, textbox "Cautious economic assumptions?", p. 49).

⁴ During the period 1998-2002, also a windfall formula for tax and social security contributions was applied. In case of a general government deficit of less than 0.75 per cent of GDP, 50 per cent of the windfall was to be used for deficit reduction and 50 per cent for additional tax relief. If the general government deficit is more than 0.75 per cent of GDP, then 75 per cent of the windfall was to be used for deficit reduction and 25 per cent for additional tax relief.

FES and the use of cost/benefit analysis in the budgetary process

The Economic Structure Improvement Fund (FES) was established in 1993. Government investments in infrastructure had fallen from about 3 per cent in 1970 to 1.5 per cent of GDP in 1993. By earmarking via the FES about 40 per cent of the natural gas revenues for financing “additional investments of national significance”, the structure of the Dutch economy should be improved. Another FES-revenue, but of secondary importance, is the interest on public debt saved due to the sale of equity of public corporations.

The Betuwelijn, a railway line from Germany to the Rotterdam harbour, was the first major project financed by the FES. It also initiated the reintroduction of cost/benefit analysis at the CPB.^{a)} At that time, the Dutch government was not at all happy with the CPB’s conclusion that such a publicly financed railway line would not be a good idea. Nevertheless, the Betuwelijn has been constructed and at present transporters are not even willing to pay compensation for using the railway line. In 2004, an official parliamentary commission (Commissie Duijvestein) published a very extensive report about what went wrong with big infrastructural projects, like the Betuwelijn and the High Speed Railway between Amsterdam and Belgium. However, lessons have been learned and for some years now, the financing of projects via the FES is scrutinized by a cost/benefit analysis. This has also stimulated the use of cost/benefit analysis for infrastructural projects not financed via the FES. All these analyses (see e.g. Dijkman and Verrips, 2002) should comply with the new national guidelines on cost/benefit analysis, e.g. with respect to the social discounting rate, the risk premium and the inclusion of indirect effects (see Eijgenraam et al. 2000 and CPB, 2003a).

Since 1993, the FES has disbursed more than 31 billion euro. In the beginning, the FES-investments mainly focused on transport and mobility, e.g. roads, railways and channels. However, now also expenditure on knowledge, innovation and the environment are financed via the FES.

Recently, changes in the oil prices doubled natural gas revenues in some years. These windfall gains were not good for political calm and drastically stimulated the urge for spending. In a very short term, the CPB had to make cost/benefit analyses of a wide range of new projects. The new official advisory group on budgetary principles recommended therefore that the FES-funding level should be decided at the start of the new government’s term. The FES-investments should be embedded in medium-term investment agendas, the projects should be selected with the aid of cost/benefit analysis which have to be proofed by the CPB or an independent scientific committee. The coalition agreement of the new government has accepted these proposals.

^{a)} In 1954, under the supervision of Tinbergen, a cost/benefit analysis was made of the Delta works. After budget cuts in the early eighties, such project appraisals were scrapped at the CPB.

European norms for actual deficit and debt

The Treaty of Maastricht in 1992 implied that monetary policy became a responsibility of the European central bank and that national fiscal policy should comply with the European norms of actual deficit and debt. Deficit should not exceed 3 per cent of GDP and debt must be below 60 per cent of GDP or be declining towards the 60 per cent norm at a satisfactory rate. According to the Stability and Growth Pact, the budget balance should be close to balance or in surplus in the long run.

As a consequence, the national concepts on public finance were replaced by the new European concepts based on the national accounts. This had several practical implications:

- A change in concepts. For example, according to the national account's concept of budget balance, revenue and expenditure like taxes and interest payments should be recorded on a transactions basis. Financial transactions like loans and the sale of equity are irrelevant and the government includes not only the state and social security funds, but also municipalities, provinces and many other non-market units mainly financed and controlled by the government.
- The concepts can not be changed anymore over time by the government.
- A link to national accounts statistics and therefore a new role for Statistics Netherlands and a more limited role of the Ministry of Finance. The official figures reported to the European Commission and European Central Bank should be consistent with those reported by Statistics Netherlands. In the end therefore, Statistics Netherlands is responsible for translating the general European concepts into operational concepts for the Netherlands and to make the best estimates for these operational concepts.

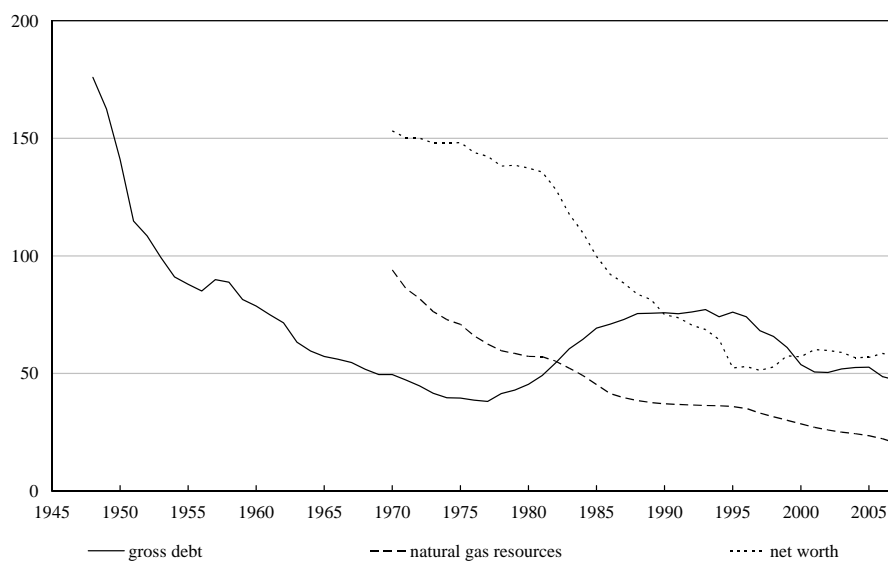
The transition towards European concepts does not imply that bookkeeping and bookkeeping tricks have become irrelevant. Like all national concepts of taxable income, the European concepts on public finance can affect actual behaviour (e.g. stimulate leasing of capital goods to reduce the deficit or stimulate the sale of public equity in order to reduce public debt) and the specific institutional arrangements chosen.^{a)} Furthermore, they are not optimal from an economic-theoretic point of view (e.g. not forward looking and ignores financial assets and implicit liabilities like future pensions) and may not well take account of the current economic situation in the Netherlands. They are the outcome of political negotiations in view of the circumstances in Europe in 1992 and the purposes of the criteria, *i.e.* to provide signals that countries are willing and able to live with the discipline required by EMU (see Bovenberg and De Jong, 1996, p. 18).

^{a)} On the merits and limitations of the EMU-targets of government deficit and debt, see also Bos (2003a, Chapter 8) and Bos (2007a).

Gross debt is not a good yardstick for the financial position of the Dutch government

Gross government debt in the Netherlands declined from 176 per cent in 1948 to 38 per cent of GDP in 1977. During the Eighties gross government debt increased to over 70 per cent of GDP and started then to decline; at present, gross government debt is below 50 per cent of GDP. This is substantially below the debt criterion of the European Monetary Union. However, this criterion only takes into account explicit debt and does not provide a complete picture of the financial position of the government.^{a)}

Gross Government Debt, Natural Gas Stock and Net Worth of the Government in the Netherlands, 1948-2007 (percent of GDP)



The major assets of the Dutch government are the natural gas stock, the fixed capital stock and the financial assets. The discounted value of the natural gas stock was 90 per cent of GDP in 1970. At present, it has declined to 20 per cent of GDP. The value of the fixed capital stock of the government, like infrastructure, buildings and computers, was 55 per cent of GDP in 1970. It increased to 74 per cent of GDP in 1983; since then it has decreased gradually to the current level of

^{a)} This was already noted at the start of the EMU. See, e.g., van Hoek and Zalm (1992).

about 60 per cent of GDP. The Dutch national accounts includes data on the financial assets of the Dutch government since 1990. In 1983 the value of these financial assets was 45 per cent of GDP. Mainly due to the sale of equity and the redemption of the loans to housing corporations, this has declined to 24 per cent of GDP.

If these assets are also taken into account, a totally different picture of the financial position of the Dutch government results. During 1970-77 gross government debt decreased with more than 10 per cent of GDP. At the same time, the value of the fixed capital stock increased over 10 per cent of GDP. However, this was overshadowed by the decrease in the value of the natural gas stock. As a consequence, net worth of the government decreased 7 per cent of GDP. In the period 1978-93 the size of government debt doubled by an increase of 38 per cent of GDP. Government's net worth decreased much stronger, due to a decrease in the gas stock (-26 per cent of GDP) and the financial assets (-9 per cent of GDP in the period 1990-93). Since 1994 Dutch gross government debt decreased with 27 per cent of GDP. This substantial decrease in debt is more than compensated by a decrease in the natural gas stock and other property: net worth decreased 14 per cent of GDP.

Analyses of the sustainability of government finance are based on discounting future expenditure and revenue and taking account of present net worth. Following these analyses, sustainability is achieved by anticipating the forthcoming costs of ageing by an increase in net worth. In particular due to the exhaustion of Dutch natural gas reserves, this is not the same as reducing government debt.

The trend based fiscal framework, budget cuts, economic recovery and some specific factors, like the increased labour market participation of women and the rapid drop of interest rates on public debt (see also Bos, 2006a), resulted in a drastic reduction of public expenditure and debt: public expenditure fell from 57 per cent in 1993 to 46 per cent of GDP this year and public debt was reduced from 77 per cent in 1993 to 47 per cent of GDP this year. However, the improvement in the net financial position of the Dutch government was much less favourable (see text box "Gross debt is not a good yardstick for the financial position of the Dutch government").

2.1 *Public debt and sustainability*

Mid-1990's, Dutch politicians explicitly addressed the issue of sustainability by creating two funds: the FES-fund and the old age state pension fund. These should help to ensure sustainability of Dutch public finance in view of the

exhaustion of natural resources and the expected rise in old age state pensions due to ageing. However, the solutions offered were only formal solutions, as they did not affect the official targets for general government balance and debt (for more details, see Bos, 2007b).

However, some years later, official medium-term policy targets for deficit and debt were explicitly linked to calculations on the sustainability of Dutch public finance. Following the seminal work by Auerbach, Gokhale and Kotlikoff (1991), the CPB started to calculate generational accounts for the Netherlands (see, e.g., Ter Rele, 1998, Van Ewijk *et al.*, 2000 and 2006). These calculations demonstrated that current policy arrangements (taxes, public expenditure on social security, education and health care, subsidies, etc.) in the Netherlands are not sustainable.

Under unchanged policies, the ageing population will lead to a sharp and structural increase in public expenditure, in particular on state pensions and health care. Government revenue from taxes on funded pensions will also increase, but not enough to cover the extra expenditure and the falling revenues from natural gas. As a consequence, in the long run without policy adjustments public debt will explode and Dutch public finance will be out of control. Adjusting policy in time is efficient (tax smoothing limits the distortion on the labour and capital market) and intergenerationally fair. Major solutions are increasing labour participation, adjusting the ageing-related public expenditure (old age state pensions and health care) and saving for later by raising taxes or by cutting other public expenditure.

The forward looking approach of generational accounting is the new paradigm for Dutch public finance.⁵ Some recent figures can illustrate the importance of this paradigm-switch for the Netherlands. According to the most recent CPB estimates, without policy change, the general government budget balance in 2011 will be a surplus 1 per cent of GDP. However, this is not sufficient for sustainability: the Dutch sustainability gap is then about 2½ per cent of GDP.

In order to monitor changes in sustainability, actual and structural general government budget balance, *i.e.* the actual balance corrected for cyclical fluctuations, are very misleading. For this purpose, the concept primary structural government balance is commonly used, *i.e.* structural budget balance minus interest payments. Current interest payments are ignored, as in the long run interest payments and debt have only a limited impact on the sustainability of public finance.

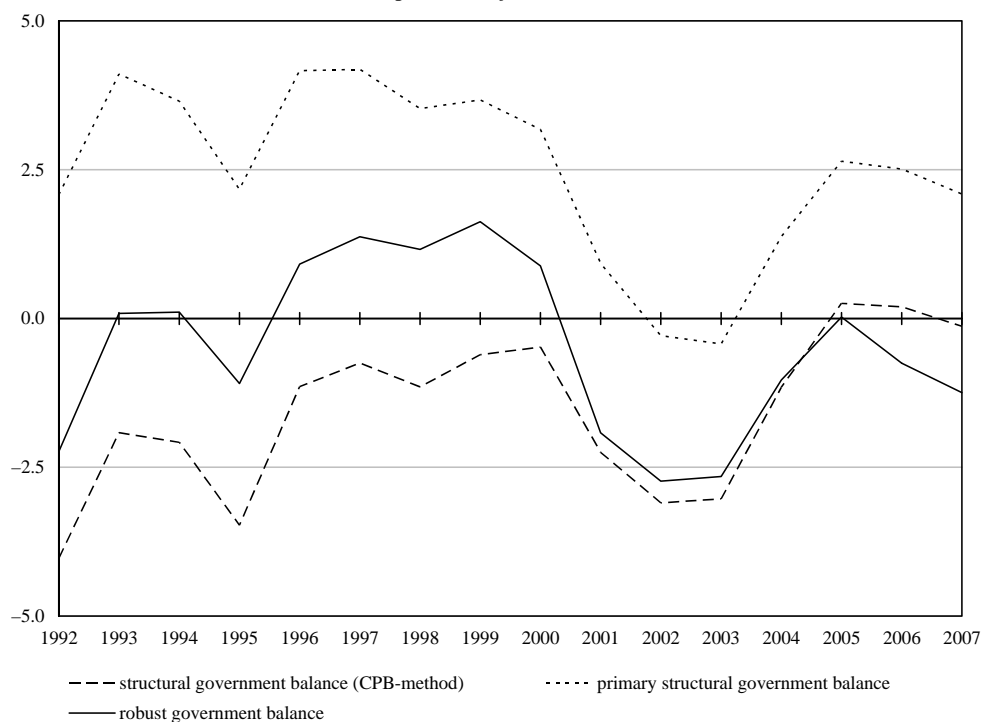
The CPB has decided to use an alternative concept for monitoring sustainability: robust budget balance.⁶ It differs in two respects from primary structural budget balance. It is equal to structural budget balance corrected not only for interest payments, but also for interest on dividend revenues and revenues from natural gas. In primary structural balance, interest payments are left out, but interest receipts and revenues from dividend are still included. As a consequence, changes in

⁵ Two years ago, the forward looking approach has been extended with an analysis of the redistribution of current Dutch policies over the life-cycle (Ter Rele, 2005).

⁶ See Ewijk *et al.* (2006).

Figure 1

**Robust Government Balance, Robust Primary Structural Balance
and Structural Balance in the Netherlands, 1992-2007**
(percent of GDP)



Source: CPB Macroeconomic Outlook 2007, p. 29.

the financial portfolio of the government, e.g. reducing government debt by selling public equity stock, change the primary balance. However, such changes are irrelevant for assessing sustainability as they reduce revenue (interest and dividend received) by approximately the same amount as expenditure (interest payments).

The second difference with primary structural balance reflects specifically Dutch circumstances. In about 25 years, Dutch natural gas reserves are expected to be exhausted. Temporary windfalls in natural gas revenues, e.g. due to changes in the oil prices, will not help to make Dutch public finance sustainable. For monitoring changes in the sustainability of Dutch public finance, also changes in the natural gas revenues are therefore ignored.

Using robust balance – and not the structural balance or the primary structural balance – really matters. For the past fifteen years, it gives quite a different picture of the changes in sustainability of Dutch public finance (see Figure 1).

Incentives as a tool for managing and controlling Dutch expenditure

In particular since 1990, the CPB is investigating the efficiency and effectiveness of the rules and institutions underlying Dutch public expenditure. Major studies have been published about social security arrangements, the health care system and education. Also the impact of immigration on Dutch public finance has been investigated. In 1997, embedded in a general analysis on the interplay of institutions, trade-offs, performance and trends, a comprehensive comparison of German and Dutch economic institutions was published (CPB, 1997). The use of explicit incentives has become one of the major issues of the Dutch public service modernisation agenda. CPB studies have investigated the usefulness of performance contracts and performance pay in various (semi-)public sectors, e.g. the social benefit administration, the police force, the education sector, universities, physicians and the major technical research institute in the Netherlands (TNO).

Incentives have now become a major tool for reorganizing Dutch public expenditure. Policy measures taken include, e.g.:

- official minimum wages have been constant in real terms since 1980; this means a substantial saving on social benefits related to this minimum wage, e.g. social assistance and state pensions. It also implies a greater incentive for looking for paid work instead of receiving social assistance;
- scholarships have become a grant conditional on the performance of students;
- since 1994, paid sickness leave has gradually become less a responsibility of the government and more that of the employer. Employers do not have to pay social security contributions for paid sickness leave, but should finance the paid sickness leave of their employees during the first two years. The purpose is to stimulate employers to reduce sickness of their employees and in this way also disability benefits;
- municipalities could claim most of their expenses on social assistance from the state. However, since 2004, they receive a fixed budget which is linked by the CPB to the macroeconomic developments. As a consequence, municipalities have now an incentive to reduce the number of social assistance benefits. This new policy was very successful, as social assistance benefits hardly increased in 2004 and 2005 despite a substantial increase in unemployment.

3 The budgetary process, expenditure ceilings and the role of the CPB

3.1 Introduction

Major elements of the current trend based fiscal framework, like the link to calculations on sustainability of Dutch public finance, the role of cost/benefit

Table 1**The Road to a New Medium-term Framework**

One year before the elections	CPB estimates of the Dutch economy and public finance in the medium and long term, assuming no changes in policy
One year before the elections	Report by the official advisory group on budgetary principles
5 months before the elections	New CPB estimates of the Dutch economy and public finance in the medium term, assuming no changes in policy
2 months before the elections	CPB analysis of the election platforms
After the elections	CPB analysis of coalition agreement
Some months after the elections	The new medium-term framework based on new CPB estimates for the Dutch economy

analysis and the introduction of incentives, have been discussed in Section 2. In this section, the focus will be on the budgetary process, the expenditure ceilings and the role of the CPB.

3.2 *The road to a new medium-term framework*

One year before the elections, the road to a new coalition agreement and medium-term framework starts. The CPB makes provisional estimates of the Dutch economy and public finance in the medium term. These estimates are later updated and supplemented with an analysis of Dutch public finance in the long run.

All these estimates serve as inputs for the official advisory group on budgetary principles. The government makes explicit which topics should at least be addressed by the advisory group. In about half a year, this group writes a report evaluating past budgetary performance and making recommendations for the next period of government. The Ministry of Finance serves as the secretary of the advisory group. The CPB provides the estimates on the economy and public finance and is often asked to take a further look into some specific issues, e.g. conduct an analysis of the consequences of alternative assumptions and principles.

In the run-up to the general elections, the CPB publishes an analysis of the economic effects of election platforms.⁷ The CPB conducts this analysis at the request of the political parties in question. In November 2006, eight election

⁷ On the merits and limitations of this analysis, see the papers in Graafland and Ros (2003).

platforms were analysed (see CPB, 2006). This was the sixth occasion since 1986 that such an evaluation of election platforms has been made.

The CPB study makes it possible to compare the parties' election platforms on economic aspects. Key elements of the analysis are the implications for public finance, macroeconomic developments and purchasing power.^{8, 9} As far as the budgetary effects are concerned, the CPB devotes attention to the implications of the proposed measures for the revenues and expenditures of the public sector as a whole (general government budget balance, debt and sustainability in the long run).

"Charting choices" is not only useful for voters, maybe not even in the first place. As soon as the results of the CPB analysis are published, the political parties use these results to defend their policy proposals. It is not unusual for politicians to bombard each other with CPB figures during election debates.

The study comes in handy after the election, during the formation of a new coalition agreement. In the Netherlands, parties usually form governments on the basis of wide-ranging coalition agreements. The coalition agreement plays an exceedingly important role during the government's term in office. It sets out the result of the give and take among the coalition partners on many policy issues. It is also the starting point for discussions on the government's decisions whether or not new developments demand a policy response.

The CPB study offers an initial overview of the economic and financial implications of the parties' proposals. It is therefore a good starting point for negotiating the terms of a coalition agreement. This applies not only to the proposals of parties involved in the coalition agreement. In practice, the CPB overview serves as a data base on all kinds of policy measures that could be considered during the negotiations; in particular the budget cuts and extra revenue generating measures by other parties are a popular source of inspiration.

The CPB provides also an analysis of the coalition agreement. The previous analysis of the election platforms is therefore a great help to make such an analysis. When no entirely new policy measures are proposed, a standard analysis (*i.e.* check on the plausibility and feasibility of the measures proposed and their *ex ante* budgetary implications, macroeconomic effects and effects for purchasing power) can be made within some days.

⁸ The macroeconomic effects concern the implications for the Dutch economy, specifically those for structural GDP, employment in the private and public sector, consumption, wages, inflation and so on. The purchasing power effects cannot be easily expressed in a single figure, because the implications of the party programmes may differ widely between types of households. These effects are therefore expressed in a scatter diagram and by means of specific figures for different groups of households.

⁹ In the analysis of 2002, also the environmental implications were taken into account. However, due to the fall of the coalition government and the consequent calling of early elections, time pressure was too high to include this environmental analysis again. Five years ago also an analysis of the strengths and weaknesses of the reforms proposed for the health care sector was included. In November last year, for the first time an analysis was included on education, science and innovation. The proposals by the parties were classified, on the basis of empirical research, into promising, not promising and proposals that can not be judged along these lines on the basis of such research.

The Ministry of Finance ultimately calculates the medium-term framework. For example, the level of the real expenditure ceilings is fixed considering the coalition agreement and the most recent information about expenditure and revenue. Other Ministries, in particular those on social affairs and health care, may also have a clear opinion on the development of the expenditure of their Ministry. Estimates by the CPB, in particular those on social security, taxes and health care, serve as a critical benchmark for fixing the medium-term framework.

This process for deciding on a new coalition agreement implies that policy measures are checked in an early stage on their feasibility and consequences on the national economy and public finance in the medium term and long run. Before the elections, the policy measures proposed by all major political parties are analysed. In drawing up the coalition agreement, also the policy measures in the successive drafts are analyzed.

3.3 The annual budgetary process

The annual budgetary process is summarized in Table 2. The CPB plays two important roles in this process. First, it provides the macroeconomic estimates, e.g. of economic growth, prices and wage rates, for the budget. These estimates play also an important role in wage negotiations for the public and private sector. Secondly, it provides elaborate estimates on Dutch public finance (see Table 3 for an overview of the standard tables and Bos, 2003b for a more extended explanation). As a consequence, there is always a critical benchmark for the estimates on Dutch public finance by the Ministry Finance. An essential feature of the CPB estimates is that they can be based on the most recent budgetary information and decision-making, even when this information is not yet officially published.

In general, for the annual debate with the government about the budget in September, several opposition parties ask the CPB to analyse also their alternative budgetary proposals. The CPB analysis of their plans serves as a check (e.g. are they realistic?) and give also an indication of their short run economic effects in terms of economic growth, inflation, general government budget balance and purchasing power of various groups of households.

3.4 The expenditure ceilings

The Dutch expenditure ceilings are commonly misunderstood. Examples of such misunderstanding are:

- the expenditure ceilings are based on conservative estimates of public expenditure;
- the expenditure ceilings assume gradually increasing or decreasing changes in public expenditure;
- the expenditure ceilings are fixed in terms of GDP;

Table 2

The Annual Budgetary Process
(*t is the budget year*)

Due dates	Activities
November $t-2$	Budget circular from Ministry of Finance to line ministries to start internal preparations
January/ February $t-1$	Provisional "Central Economic Plan" by CPB to ministries containing updated macroeconomic and public finance estimates for the budget year and beyond.
February $t-1$	Line ministries send policy letters to Ministry of Finance indicating spending priorities and likely budgetary developments
March/April $t-1$	Preparation of recalibrated multiyear expenditure framework, with proposed shifts in allocations/cutbacks brought to cabinet by Ministry of Finance, based on policy letters
March $t-1$	"Central Economic Plan" published by CPB on the basis of unchanged policy
April/May $t-1$	Decision by cabinet on expenditure side of the budget. Sent out by Ministry of Finance to line ministers in "Totals letter"
May/June $t-1$	Detailed negotiations between Ministry of Finance and line ministries on composition of their budgets
Early June $t-1$	"Provisional Macro Economic Outlook" by CPB to ministries; this contains updated estimates on the Dutch economy and public finance; this incorporates new fiscal decisions
June $t-1$	"Spring memorandum": parliament is informed on outline of current years budgetary plans and on budget execution in first quarter
August $t-1$	Further fine-tuning of budget on the basis of provisional macroeconomic outlook provided by CPB to ministries and decision-making on the income side of the budget
3rd Tuesday September $t-1$	Submission of State budget to parliament together with CPB's Macroeconomic outlook (MEV)
September $t-1$	Discussion of State budget in second and then in first chamber of parliament. First general political and macrofiscal discussion, then discussions per budget chapter. Input for general discussion also CPB analysis of budgetary proposals opposition parties
Before end December	Approval by both chambers of parliaments of all budget chapters

Table 3**CPB Standard Tables for Monitoring and Analysing Dutch Public Finance**

Table	Explanation
Key-figures Dutch public finance	Public revenue, expenditure, government balance and debt as percentage of GDP
	Some other information, e.g. annual change in employment in general government, change in wage rate in general government, ratio of inactive versus active
	Footnotes indicate quantitative impact of major incidents and institutional changes; this is essential for proper interpretation
Public expenditure by function	Public expenditure by function as a percentage of GDP, volume changes (percent) and price changes (percent), GDP volume and price change
Volumes of major social benefits	Absolute number of social benefits for major regulations, e.g. old age act, sickness act, disablement act, unemployment act and social assistance
Public expenditure and the expenditure ceilings	A comparison in billion euros of the expenditure ceilings drawn up at the start of the government and the most recent estimate of the expenditure subject to the ceiling
Social security contributions	Overview of official tariffs, thresholds (income, 65+), maxima and deductible items (e.g. for working)
Micro-tax burden	An overview in billion euros of the changes in the micro-tax and social security burden due to policy; corrections are made for shifts between private and collective arrangements (e.g. health care and social security)
Tax and social security revenue	An overview of the major taxes and social security revenue as a percentage of GDP (e.g. wage tax, VAT and corporation tax)
	The annual change as percentage of GDP is broken down into changes due to policy and other changes (e.g. changes in economic growth, purely administrative changes in the collection of tax revenue)

- due to the use of expenditure ceilings, unexpected deteriorations in the general government budget balance can only occur due to unexpected reductions in tax and social security revenues, e.g. related to unexpected lower economic growth.

A major purpose of this section is therefore to address these misunderstandings; a more elaborate discussion can be found in Bos (2007b).

3.4.1 Expenditure ceilings reflect the coalition agreement and realistic expenditure estimates

The multiannual expenditure ceilings are determined at the start of a new term of government. They are not simple policy ambitions about the size of public

expenditure as a percentage of GDP without any clear and realistic underpinning. They are bottom-up calculated levels of expected public expenditure in constant prices. They reflect the coalition agreement and are intended to be realistic estimates of the expected expenditure.

Cautious economic assumptions about growth only affect these estimates to a limited extent. For example, current expenditure on education and police are mainly extrapolated on the basis of demography. Furthermore, higher volumes in unemployment benefits are partly compensated by a more modest development of wages. The major exception are therefore the expenditure on health care: the high income elasticity of health care (e.g. reflecting the luxury good character of health care) ensures that a lower assumption of economic growth implies also a lower estimate of health care expenditure.

For determining the expected social security benefits and health care under the expenditure ceiling, the CPB estimates serve as a critical benchmark. This helps to avoid (political) biases in determining the expenditure ceiling. Nevertheless, estimating the budgetary effects of new policy measures is subject to substantial uncertainty and estimation errors influence the margin for expenditure under the ceiling. For example, a new policy measure much more successful in reducing expenditure on social assistance benefits leads to an unintended additional margin for expenditure.

The coalition agreement may imply specific time patterns, e.g. first the sour of budget cuts and then the sweet of tax relief and extra expenditure. This could reflect political economy considerations (maximizing the votes for the next election), but may also be motivated by administrative arguments: it takes time to organize reforms and their benefits will arrive with substantial delay. Such previously agreed time patterns in government expenditure and revenue may unexpectedly imply a pro-cyclical policy.

3.4.2 Delimitation, flexibility and possibilities for substitution

In 2006, net expenditure under the ceilings amounted to 38 per cent of GDP. Three different ceilings are distinguished: net state expenditure narrowly defined (18 per cent of GDP), expenditure on social security and labour market affairs (11 per cent of GDP) and expenditure on health care (9 per cent of GDP).

Table 4

Expenditure Ceilings and General Government Budget Balance, 2006
(percent of GDP)

State taxes and social security contributions	38.4
Net expenditure by the state narrowly defined	18.4
General transfer to municipalities and provinces	2.7
Revenues of old age fund	-0.7
Other revenues (e.g. fines, school fees, dividend, interest received)	-1.4
Other net expenditure (e.g. wages, transfers to schools, interest payments)	17.8
Expenditure on social security and labour market	10.8
Expenditure on health care	8.5
Total net expenditure under the expenditure ceiling	37.7
Net other expenditure	0.6
Natural gas revenues	-1.5
Old age fund (minus)	0.7
FES-expenditure on infrastructure and innovation	0.4
Social assistance in cash for health care	0.5
Other (e.g. cash versus accrual, local government, administrative costs health care)	0.4
General government budget balance	0.2

The ceilings do not only cover expenditure, but also some revenue, like fines, school fees, dividend of the central bank and state corporations and interest received. This implies that extra expenditure under the ceiling could be financed via raising some of these revenues and that set backs in these revenue should be compensated by reducing expenditure. The IMF questions the merits of including such revenues under the expenditure ceiling.

In principle, three different budget sectors with specific expenditure ceilings for each sector are distinguished. However, since 1994, shortages at one ceiling (notably health care) were several times compensated by surpluses at other ceilings.

To some extent, shortages and surpluses can also be shifted in time. For example, departments are allowed to shift 1 per cent of their expenditure to the successive year. Furthermore, the expenditure under the ceiling are mostly recorded on a cash basis. As consequence, by advancing or postponing payments and receipts, e.g. with respect to infrastructure, expenditure under the ceiling can be managed.

Since 2002, there is a clause that cyclical windfall in expenditure under the ceilings should not be spent. However, these windfalls were not precisely defined; as a consequence, the clause could be used by the Minister of Finance in a discretionary and flexible way.

Public health care expenditure are a major challenge for the expenditure ceilings. They are a major item of public expenditure, have been increasing rapidly for many years and may also grow more than expected when drawing up the expenditure ceiling. This rise in public health care expenditure can be reduced by shifting between public and private expenditure, e.g. by reducing the standard health care package. In the Ministry of Finance's monitor of the tax burden, this is not regarded as an increase of the tax burden. Such solutions for health care expenditure exceeding the ceiling are thus allowed. But in the CPB concept of tax burden used for monitoring and analysing Dutch public finance, such solutions are nevertheless presented as an increase in the tax burden.

The expenditure under the ceiling might also be 'controlled' by substitution with tax expenditure (see Hemels and Ros, 2006). However, in principle, the ceilings are corrected for such institutional changes. Furthermore, new tax expenditure could be signalled by a separate monitoring of such expenditure. In the period 1994-2001, there was no explicit monitoring or evaluation of tax expenditure. The Budget of 2001 contained a first set of criteria for tax expenditure. In the Budget of 2003, new explicit criteria were introduced for tax expenditure, e.g. is the purpose SMART (Specific, Measurable, Agreed, Realistic and Timebound), why is government intervention required and why is tax expenditure the preferred tool?

Since 1999, the budget contains a separate chapter on tax expenditure; this includes an overview of the major tax expenditure, e.g. income tax reduction for specific groups, VAT differentials and tax reduction for employers for employees with parental leave or long-term unemployed. According to the most recent overview in the budget, tax expenditure as a percentage of GDP was 2 per cent in 2006. However, some experts argue that several major items of tax expenditure are ignored, e.g. the different treatment of pension savings *vis-à-vis* other savings,¹⁰ the personal income tax deductibility of interest on mortgages, labour tax credit, child tax credit and the tax credit for bread winners (*i.e.* for households where only one of

¹⁰ Contributions to supplementary pension schemes are tax-deductible, but the pension payments in due course are taxed.

the parents earns labour income). This does not serve a proper allocation: unexpected increases in major items of expenditure like health care and education are restricted by expenditure ceilings, while unexpected increases in major items tax expenditure are not restricted at all and even fully ignored.

An alternative substitute for expenditure under the ceiling are guarantees or cheap loans. The budget contains also an overview of these guarantees, e.g. for loans by public and private non-profit institutions. According to the Budget 2007, the financial risk of state guarantees was about 12 per cent of GDP in 2006.

3.5 Understanding the role of the CPB

The CPB plays an important role in the financial and economic decision-making process in the Netherlands (see also CPB, 2003b). The CPB's short-term, medium-term and long-term estimates of the Dutch economy and public finance are the backbone of the budgetary process. Political parties and the government ask the CPB to analyse the economic effects of their election platforms, coalition agreements and alternative budgetary proposals. Strategic economic thinking and decision making is influenced by CPB studies, e.g. general long-term scenario analyses and specific studies about the welfare state, education, innovation and health care. The decision-making process about major specific projects, e.g. on infrastructure, is guided by cost/benefit analysis by the CPB. The CPB is also represented in influential advisory groups, e.g. the Central Economic Commission, the Socio-Economic Council and the Official Advisory group on Budgetary Principles.

How should this dominant role be understood? What is the logic behind this role? How can the CPB serve as an independent expert, while being financed completely by the Dutch government? How can the quasi-monopolistic role of the CPB coincide with a good quality of the estimates and analyses?

The role of the CPB as advisor and arbitrator fits well in the Dutch tradition of consultation and coalition governments. Directly after the Second World War, the CPB had a good start (see Boogaard, 1998, Bos, 2006, pp. 232-37 and Passenier, 1994). The need for a joint strategy for economic recovery gave a clear role for the CPB estimates and analyses. Furthermore, the outstanding qualities of Jan Tinbergen both as economist and political advisor and as a moral authority contributed directly and indirectly to the appreciation of the CPB work.

Provided the CPB is independent and provides good quality estimates and analyses, then the dominant role of the CPB can be regarded as an efficient solution. It avoids unnecessary duplication of work and avoids discussions about which estimate is the best. It ensures continuity which is essential for both producers and users of policy advice. For example, for specific topics standard tables can be used. Continuity is essential for building up expert knowledge about Dutch institutions. It also important for generating specific skills and tacit knowledge essential for policy

advice, e.g. how to handle confidential inside knowledge and how to meet tight time schedules essential for coalition agreements.

The independence of the CPB is arranged in various ways. “First there is the formal structure, as laid down in the law of 1947. It is a very short and simple law, which regulated e.g. the appointment procedure of the members of the Board of Directors and the existence of the Central Planning Commission. The members of the Board of Directors are appointed for a long period by the Minister of Economic Affairs in consultation with seven other Ministers named in the law. So a broad support for those appointments is required. But more important than formal law are tradition and practice developed in Dutch social-economic life for forty years, which have strengthened the independent position of the Bureau. For the Bureau itself it is essential to maintain its independence. The position and prestige of the Bureau would be seriously weakened, if the general public or the oppositional parties would no longer trust its unbiased judgement. Also, checks and balances exist in the democratic system. For instance, when assessing the economic consequences of policy programmes of political parties, the Bureau works for several political parties. All assumptions and results are published and, in principle, can be verified. Also the model, the data and the results for the forecasting period are made available. Pressure put on the CPB by Ministers or Ministries evokes counter forces. The parliament and the press are quick in scenting trouble. The permanent Parliamentary Commission for Economic Affairs regularly invites the Director of the CPB to discuss recent publications of the Bureau. This Commission is also keen on any hint of pressure of the government on the Central Planning Bureau. And the free press is perhaps the best ally one can have to protect independence in an open democratic society” (Don and van den Berg, 1990, pp. 20-1).

This extensive quote from a nearly two decades old paper is still relevant. Three elements could be added:

- Yearly, the CPB receives advice regarding its work plan from two organisations: the Central Planning Committee, containing members from business and science, and the Committee for Economic Affairs, with official representatives of Ministries that are most closely involved in economic policy. The Committees’ work provides an important external check on the policy relevance of the CPB work.
- About every five years, the policy relevance and scientific quality of the CPB work is assessed by visitation commissions (see e.g. CPB, 2003c). The Central Planning Committee advises on the composition of the visitation commissions.
- Substantial mobility of personnel, e.g. people moving between CPB and universities, ministries, trade unions, politics and the press. This ensures that the CPB is not an ivory tower and that there is outside the CPB a lot of inside knowledge about the merits and limitations of CPB work.

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