



Budgeting under expenditure rules in the Netherlands



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Outline

- Importance of fiscal rules
- History of fiscal rules in the Netherlands
- Characteristics of trend-based budget policy
- Dutch mistakes: lessons learned





Why budget rules?



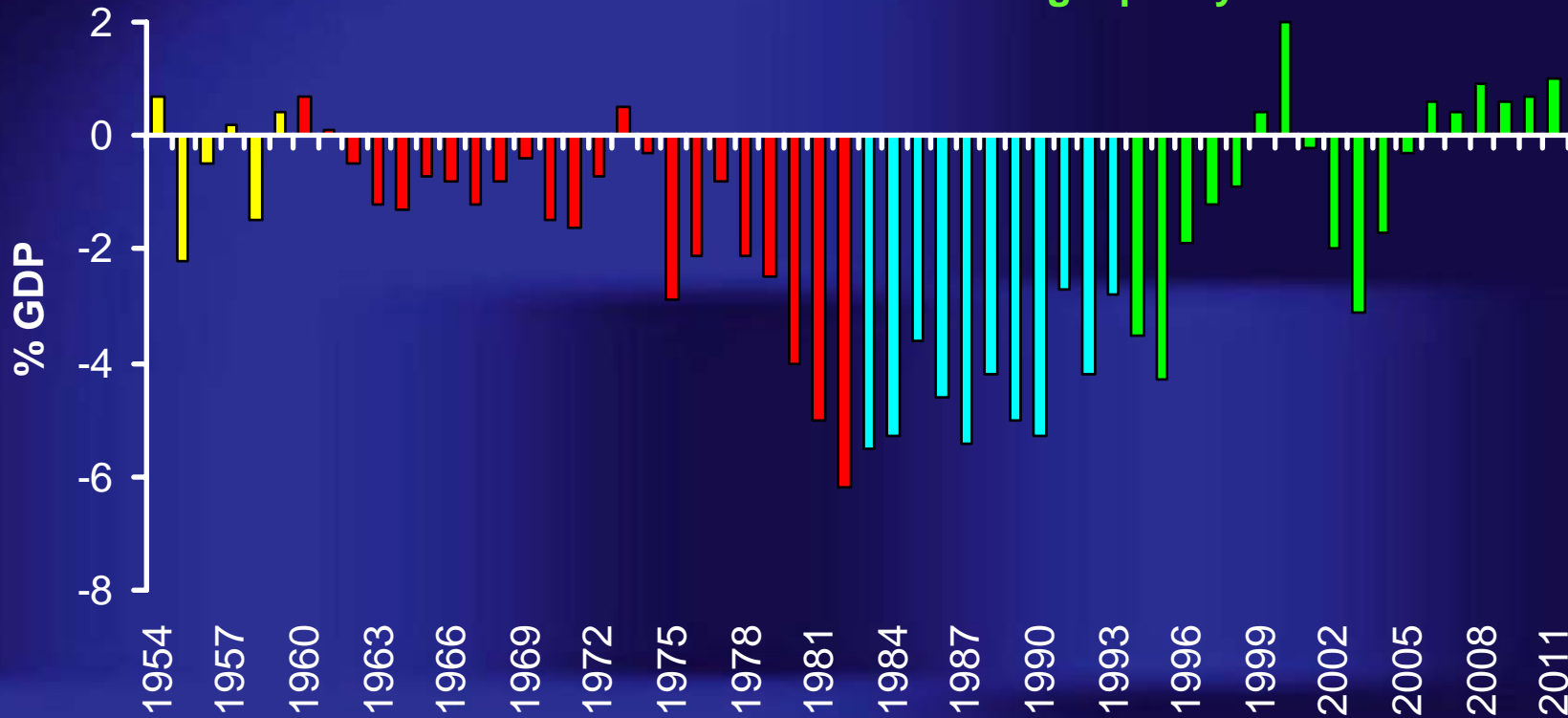
- To create **certainty**: reliable and predictable government
- To help maintain **political agreement** in coalition
- To decide on **priorities**
- To meet **European demands** (balance and debt)

- To keep politicians from spending too much!



History of fiscal rules

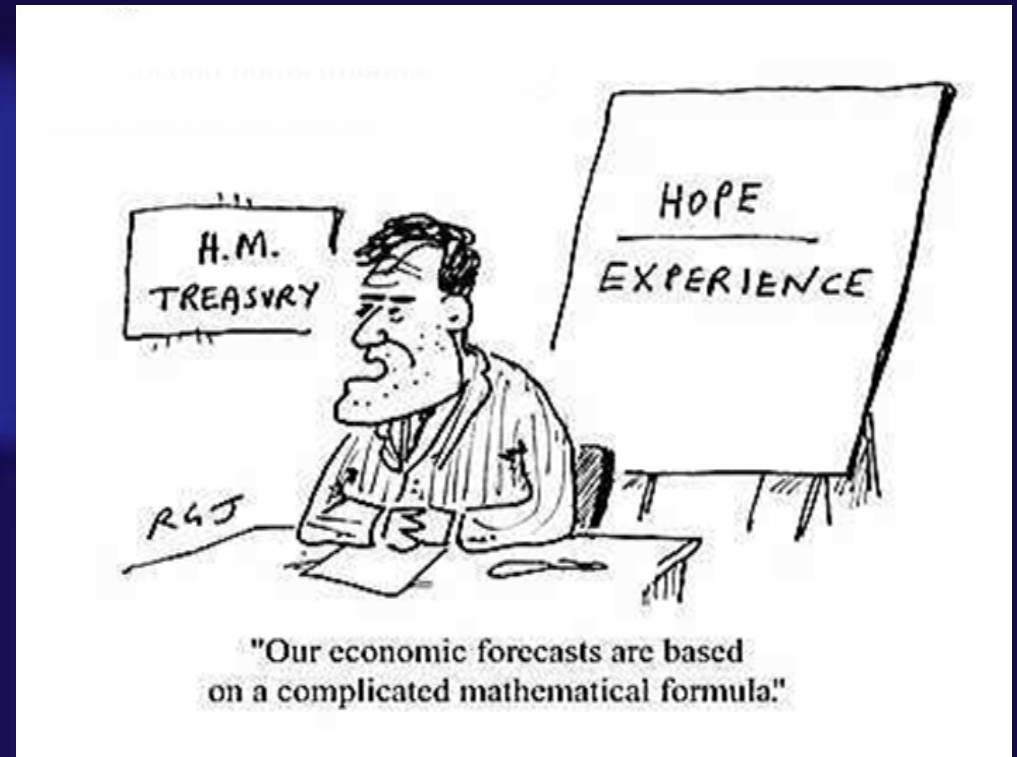
- 1950-1959: Anti-cyclical budget policy
- 1959-1983: Structural budget policy
- 1983-1994: Actual deficit policy
- 1994-now: Trend based budget policy





50's: Anti-cyclical budget policy

- Trust in economic **models**
- **Timing** problems:
pro-cyclical results!
- International **influences**



60's and 70's: **Structural budget policy**

- **Structural deficit:** room for expenditures and tax-reduction
- Underestimate **structural deterioration:** Dutch disease
- **No reaction** to increasing deficits





1983-93: Actual deficit standard

- Regaining control: **crisis management**
- Time path for **actual deficits**
 - **Ignoring** cyclical developments
 - **Hectic** budget process
 - Focus on **short term** solutions: one-off's and financial engineering
 - **Cyclical windfalls** used for structural expenditure

Since 1994: Trend-based policy

- **Sound** economic assumptions
- Clear **distinction** between expenditure and revenues
- Fixed real **expenditure framework**
- Framework for **burden of taxes** and social contributions
- Decision making **once a year**





Medium-term **economic outlook**

- Every four years, preliminary to elections
- Assuming unchanged policies
- Basis for calculating budgetary room
- Economic growth 2% (realistic scenario)
- By Netherlands Bureau for Economic Policy Analysis (CPB)



CPB

- Independent
- Responsible for:
 - Economic forecast (Medium Term and Short Term)
 - Economic policy analysis
- Macro-economic forecast serves as basis for budget
- MoF estimates budget balance but CPB used as benchmark



Fixed real **expenditure framework**

Multi-annual expenditure forecast (MT outlook) +

Economic effects of new policy proposals =

Expenditure framework (in real terms)

Adjusted for actual level of price- and wage inflation =

Nominal expenditure 'ceiling' per year



Multi-annual **expenditure forecasts**

- Forecasts based on estimates of **all budget-lines**
- **Agreement** with spending departments on multi-annual expenditures (commitment)
- Every line ministry has its own **individual budget law**
- **Ministers are responsible** for their own budget
- Budget total acts as '**ceiling**' for individual line ministries

Financial Management **in the Netherlands**

- **Decentralized** system: great responsibility for spending department
- Strong (powerful) **Financial Economic Directorates**
- Many **budget-holders!**
- **No ex-ante checks** on small commitments by FED's; budget-holders are responsible
- **No ex-ante control** on commitments by MoF
- Payments follow commitments **without further checks**



Budget discipline rules

- Budget overruns must be **prevented** or **reported** to MoF
- Every budget overrun must be **compensated** elsewhere
- **Autonomous** windfalls must be 'saved'
- Changes in budget line must be **approved** by MoF
(Inspectorate of the budget)



Framework for **tax burden**

- Full **automatic stabilisation** on revenue side of the budget
- Framework for **policy induced** changes (rates)
- Tax burden to remain **constant** during government term
- All **major decisions** ex ante in Coalition Agreement





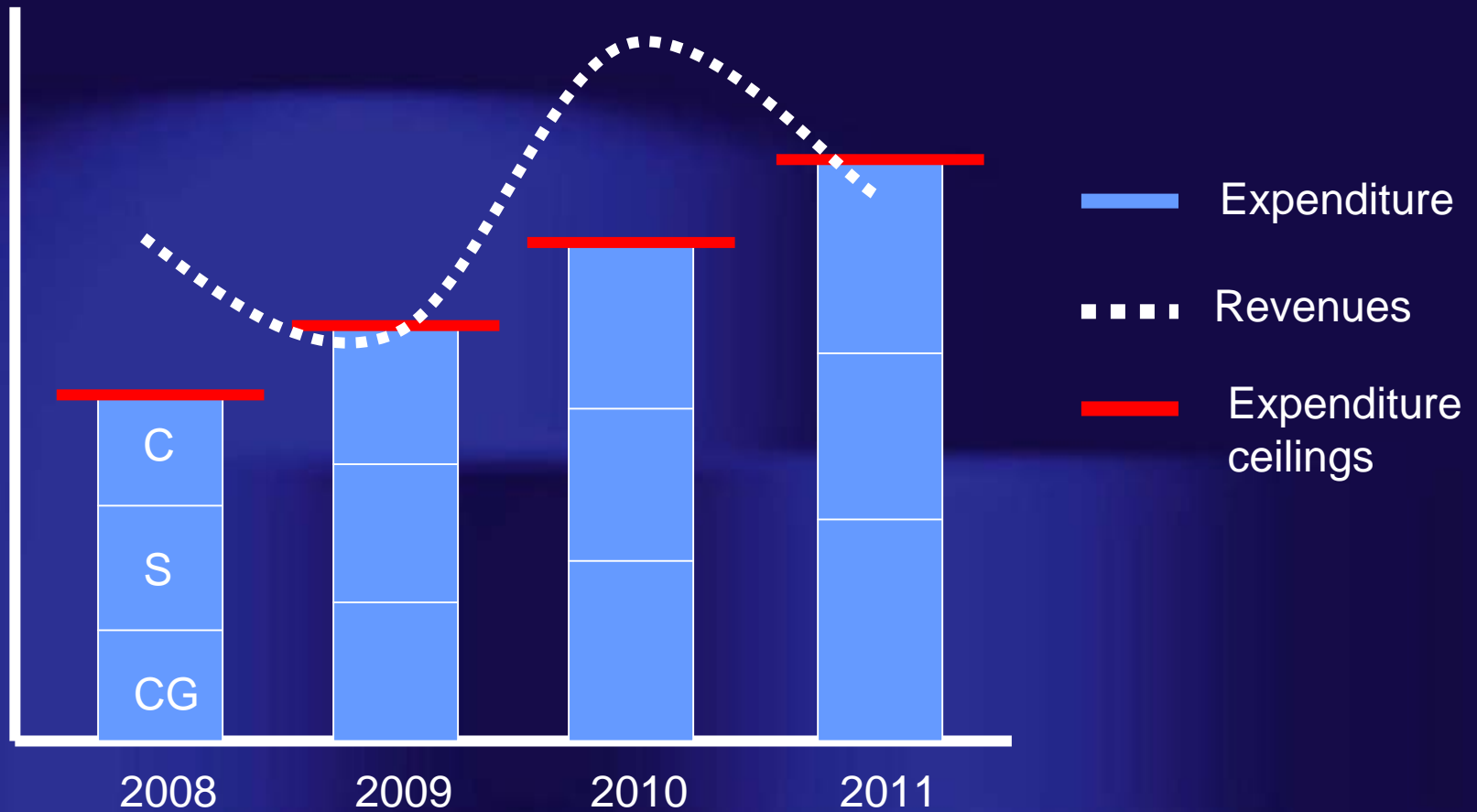
What to do with **revenue windfalls**?

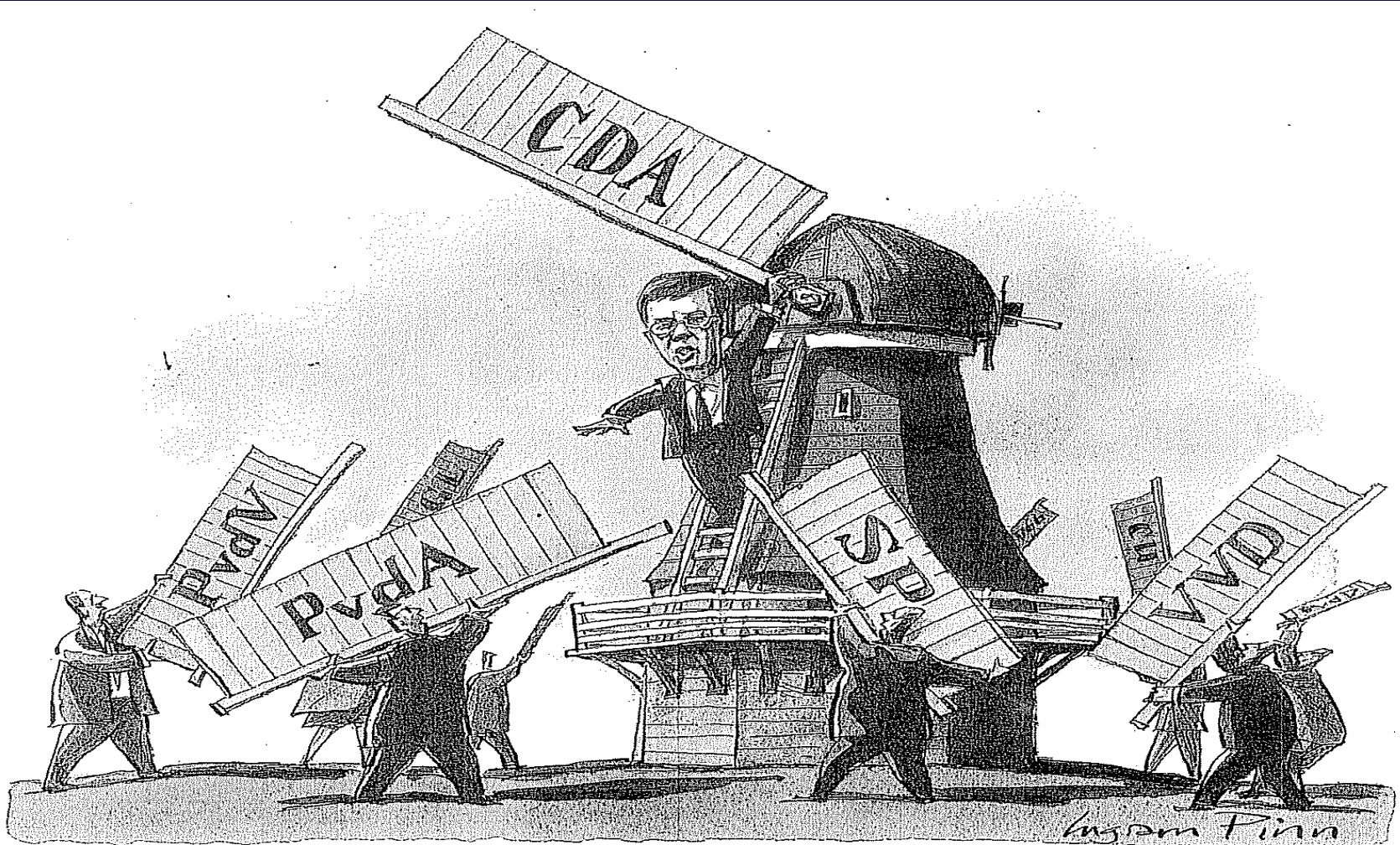
- 1994: Only deficit reduction or tax cuts, no additional expenditure
- 1998: Windfall formula to determine ratio deficit reduction/tax cuts
- 2003: Full automatic stabilisation and 'ceiling' for tax burden

- A real struggle
- Incremental process
- Warning levels for deficit



In one easy graph....





GOING DUTCH

Current Coalition: **Balkenende IV**





Coalition Agreement

- **No legal status, but politically binding**
- **Sets targets for medium term**
- **Specifies political priorities: cutbacks and new policy proposals**
- **Fiscal rules (even opposition parties accept them!)**

Cyclical elements **in the framework**

OECD/IMF recommendations: exclude cyclical elements from framework

- Interest payments
- Unemployment benefits



Dutch mistakes: lessons learned



- 1: **Do not react** to cyclical effects
- 2: Keep it **simple**
- 3: Be **cautious**
- 4: Without (political) **commitment**: no success
- 5: Decision making **once a year**
- 6: Making **exemptions** is risky, but do not be too strict

Budget Day

