March 2006
IMF Country Report No. 06/124

Kingdom of the Netherlands—Netherlands: Report on the Observance of Standards and Codes—Fiscal Transparency Module, and the Aide-Mémoire Regarding the Fiscal Framework

This Report on the Observance of Standards and Codes on Fiscal Transparency Module for the Kingdom of the Netherlands—Netherlands and the Aide-Mémoire were prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed in March 2006. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of the Kingdom of the Netherlands—Netherlands or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund ● Publication Services
700 19th Street, N.W. ● Washington, D.C. 20431
Telephone: (202) 623 7430 ● Telefax: (202) 623 7201
E-mail: publications@imf.org ● Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

Report on the Observance of Standards and Codes (ROSC) Fiscal Transparency Module

Prepared by the Fiscal Affairs Department

Approved by M. Deppler and T. Ter-Minassian

March 13, 2006

EXECUTIVE SUMMARY

The Netherlands achieves or exceeds the good practice standards against each of the four general principles of the fiscal transparency code. Dutch fiscal management institutions are unique in several respects. Three elements in particular should be emphasized: the technical reputation and political independence of the Netherlands Bureau for Economic Policy Analysis (CPB); the trend-based fiscal framework which establishes political agreement over expenditure ceilings and macroeconomic constraints over each cabinet period; and the integrity and independence of the Court of Audit (COA), the CPB, and Statistics Netherlands that collectively give assurance of sound financial data and management processes.

The roles and responsibilities of and within government are, in general, clearly defined and, in many areas, the Netherlands sets best practice standards. The CPB provides an exemplary model for separating political and technical elements of macroeconomic policy. This institution, combined with the well-articulated fiscal framework, provides a strong anchor for reliable and transparent fiscal policy setting and execution. The legal and administrative framework for fiscal management gives a clear distribution of responsibilities for financial management and appropriate checks and balances between institutions. Further steps to track and control local authority contributions to the EMU budget deficit of general government are being taken. A review of ministerial control of semi-autonomous public bodies (ZBOs) is also underway.

The Netherlands has a very open and well understood system of fiscal management. The basic principles of the trend-based fiscal framework include the separation of tax receipts and outlays, a stable and well-defined set of expenditure rules, and use of expenditure ceilings to implement policy. The framework is supported by a well established and open system of public management, with, on the whole, clearly-defined, reliable procedures for budget formulation, execution, reporting and internal audit. Budget management is to a large extent delegated to strong Financial Economic Affairs Directorates of line ministries. The decentralized administration does, however, bear some risk for quality control of complex processes, such as PPPs, policy evaluation, and further steps to consolidate the system of performance budgeting (VBTB). The dual cash-commitment system for the ministries, and accrual accounting system for agencies, ZBOs, municipalities, and other local governments leads to some uncertainties and delays in reporting general government activity in ESA95 terms for the EMU balance.

The budget and accounts documents are of a high standard and provide comprehensive, timely, and reliable information on government activity in an accessible format. Coverage and accessibility standards of the fiscal transparency code and the IMF Special Data Dissemination Standard are fully met. The VBTB structure of the budget preparation provides a logical format for understanding line ministry policies, activities and performance targets, but further work is required on improving focus and accessibility of budget documents. The consolidated information provided in the budget memorandum on local government could be improved.

Fiscal data quality standards are high and the institutional framework for maintaining the integrity of the fiscal management system and data are at, or close to, best practice-level. The independence and broad mandate of the COA give assurance of effective external oversight of government fiscal management practices (although with limited scope to the audit of spending of central government funds by municipalities). The independence of the CPB, by well-established practice and general public and political support, gives assurance of objective macroeconomic analysis. The capacity for independent macroeconomic analysis by the DNB adds assurance in this respect. Statistics Netherlands is well respected and has legal and technical independence which provide assurance of continuing high standards of fiscal data quality.

Contents

Abbreviations

CEP	Central Economic Plan
COFOG	Classification of the Functions of Government
CPB	The Netherlands Bureau for Economic Policy Analysis
DNB	De Nederlandsche Bank (the Netherlands Central Bank)
DSTA	Dutch State Treasury Agency
ESA95	European System of Accounts, 1995
EU	European Union
FEZ	Financial directorates of ministries
FES	Fund for Structural Enhancement of the Economy
FIDO	Law on finance of decentralized government
GAA	Government Accounts Act
GFS	Government Finance Statistics
GFSM 2001	Government Finance Statistics Manual, 2001
IFAC-PSC	International Federation of Accountants—Public Sector Committee
MEV	Macroeconomic Outlook
MOF	Ministry of Finance
FJR	National Annual Financial Report
OECD	Organization for Economic Cooperation and Development
ROSC	Reports on the Observance of Standards and Codes
SDDS	Special Data Dissemination Standard
VBTB	Performance budgeting system
ZBO	Semi-autonomous body

List of Websites

Ministry of Finance

Main website	www.minfin.nl
Budget documentation	www.rijksbegroting.nl
Laws, regulation and policy documents	www.rijksacademie.nl
Website of the Debt Management Agency	www.dutchstate.nl
PPP Knowledge Centre: http://kenniscentrumppps.econom-i.com/uk/pps/kennis_intro.html	

Ministry of Interior and Kingdom Relations	www.minbzk.nl
Statistics Netherlands	www.cbs.nl
Netherlands Court of Audit	www.rekenkamer.nl
The Netherlands Bureau for Economic Policy Analysis	www.cpb.nl
The Netherlands Central Bank	www.dnb.nl

I. DETAILED DESCRIPTION OF PRACTICE[1]

A. Clarity of Roles and Responsibilities

Definition of government activities

1. **General government is defined consistently with Government Finance Statistics (GFS) principles, and is well covered in the budget process.** *1.1.1*
The units of general government and their relative importance are shown in Box 1. The main categories of central government, local government, and social security are clearly defined consistently with *Government Finance Statistics Manual 2001* (GFSM 2001) and European System of Accounts 1995 (ESA 95) principles. Central government organization since the early 1990s has extensively applied an agency model of government with the aim of improving effectiveness of service delivery. Two types of agency have been established: the departmental agency, which is under full ministerial control and part of a line ministry budget, and the so-called "Zelfstandige Bestuursorganen" (ZBOs), or semi-autonomous public bodies, not directly under ministerial control. Local government budgets are not included in a consolidated budget (though financing through general and specific purpose grants is included in the central budget). Local governments report quarterly to Statistics Netherlands for purposes of Eurostat consolidated reporting on the European Monetary Union deficit (hereafter, EMU-deficit). This information is used by the Ministry of Finance (MOF) for monitoring fiscal policy developments of general government.

2. **Ministerial agencies are designed to provide a more effective and accountable mechanism for service delivery, but make government reporting more complex.** *1.1.1*
At present, 39 of these departmental agencies provide services under performance contracts with their ministry and have accrual-basis accounting and budgeting operations. Staff numbers are estimated at around 65,000 (about 55 percent of the civil service); staff, however, remain civil servants and the agency budget is included in the parent ministry

---

[1] The report was prepared by an IMF team consisting of Messrs. M. S. Kumar (head), W. Allan, M. Skaarup, and H. van Eden, which visited the Hague on December 6–21, 2005. During its visit, the team held discussions with Mr. Zalm, Minister of Finance, and with a wide range of senior staff of the Ministry of Finance and spending ministries, including representatives from several line ministry directorates of finance (FEZ). The mission met with the Director of the Netherlands Bureau of Economic Policy Analysis (CPB), Mr. Don, and senior CPB officials, and with senior officials from Statistics Netherlands, the Court of Audit, De Nederlandsche Bank (DNB), the Dienst Regelingen of the Ministry of Agriculture, Nature Management and Fisheries, the Board for Health Care Insurance, the Rabobank the State Debt Management Agency, South Holland province, Delft municipality, and a member of the parliamentary Council of Economic Advisors. The mission's visit was coordinated by Mr. Vossers, Director of the Budget and very ably guided throughout by Messrs. van Hengel and Zwerk of the Ministry of Finance.

budget. The parent ministry is responsible for policy and contract oversight, as well as developing common systems for management. Although in some cases there are difficulties in delineating and coordinating the policy and implementation roles, the model appears to provide effective incentives for improved efficiency and effectiveness. Accrual basis reports appear to be well established for reporting on financial information by agencies within ministries, but aggregate reporting on an ESA95 basis is not yet sufficiently well integrated for timely tracking of the EMU deficit. Agencies' scope to borrow is limited to allowance of a 5 percent reserve relative to the agencies' budget. Any contingent liabilities that arise from agency contracts with third parties (say, in implementing European Union (EU) regulations) are reported on by agencies and are absorbed in the ministry's budget if needed.

Box 1. General Government and its Expenditure in The Netherlands	Percent of GDP 2004
General government in the Netherlands comprises the following :	46.3
Central Government Units Covered by the Budget	
1. State organs and ministries: including monarchy, legislature, Council of State, judiciary, and 13 ministries; budgetary funds (Agricultural Equalization Fund Part A, Infrastructure, Investment Account Fund, Mobility Fund, Municipality Fund, Province Fund)*	9.5
2. Ministerial agencies (29)	1.2
3. Special Funds: Fund for Structural Enhancement of the Economy (FES)	0.4
Central Government Units with Individual Budgets	
4. Semi-autonomous public bodies (ZBOs): schools (7720) universities (14); public corporate organizations (25); boards and councils (4, including the Social and Economic Council of the Netherlands (SER)); nonprofit institutions and national organizations (including Forestry Commission)	2.2
Central Government Social Security Funds	
5. Social security schemes (11) and other funds (2) administered by 4 executive bodies: Health Care Insurance Board; Executive Body Employment Insurance; Social Insurance Bank; and Central Administrative Office Special Medical Costs.	16.9
Local Government	
6. Provinces (12); municipalities (489); communal agreements (406 units, covering technical services, regional fire brigades, port authorities etc.); public water boards (47, reduced to 26 in 2005); special education (412); and nonprofit institutions (28).	16.1

* Net of transfers to provinces and municipalities

Source: Data provided by the authorities.

3. **The ZBOs have a wide range of mandates and concern has risen on their governance and financial accountability**.

1.1.1 There are nearly 8000 ZBOs (however, including 7720 schools) that implement public tasks, largely, but not exclusively funded by central government. Total expenditure of ZBOs in 2004, as shown in Box 1, amounted to some 10.8 billion euros (2.2 percent of GDP).

ZBOs range from individual schools to large public entities, such as Statistics Netherlands which employs more than 2000 persons and the regionally organized police forces. The main rationale for creation of ZBOs, which operate under specific laws and sometimes under private corporate law is, in many cases, the need for independence from ministerial control or the implementation of repetitive activities. However, in many cases the ZBOs operate in close contact with their former ministries and behave in most respects like agencies focused on policy implementation.[2] In case of changing policy priorities, it has sometimes proven difficult to realign ZBOs with the new priorities; ministers are still publicly perceived as being responsible for policy implementation. Spending constraints vary also depending on the relationship with the ministries. Some of the smaller ZBOs, and those organized as limited companies, are allowed to borrow freely on the capital market,[3] while employment status and remuneration of many ZBOs has been disconnected from those set in central government.[4] The latter has given rise to substantial pay increases of management in some ZBOs, raising concerns about the appropriate use of public monies. The present heterogeneity of government agencies and their governance structure cannot be seen as conducive for fiscal transparency.

4. **The government is currently re-examining the status of ZBOs with regard to the ministerial relationship and other factors.**
Bodies that appear to require political distance, such as the Securities Supervisory Board, the Dutch Central Bank and the telecommunications market regulator are seen as appropriate ZBOs. Other organizations that implement a mix of public and private sector tasks, such as the chambers of commerce, and the association of car maintenance companies (which carries out the mandatory, annual checking of road vehicles) are also seen as likely to retain ZBO status. ZBO's which are engaged in large volume, repetitive, public activities in important policy areas are under active consideration for reconversion to departmental agencies.

[2] An example is the Board for Health Care Insurance (CVZ), which is designated as a ZBO and is legally independent of the Minister of Public Health, yet works under similar conditions to a departmental agency and consults closely with the minister. In contrast, some agencies of government (notably the Netherlands Bureau for Economic Policy Analysis (CPB), which is described in more detail in Box 4) work independently of ministerial direction.

[3] All ZBOs having a budget above 14 million euros (currently 43) are obliged to bank at the MOF. In most cases, the responsible ministry approves the yearly plans and budgets.

[4] Both departmental agencies and ZBO's are part of general government from a statistical point of view. If market activities are pursued by ZBO's these are separated from the public policy task in the national accounts.

Government relations with financial and nonfinancial public corporations and the private sector

5. **Laws governing private sector activities are generally transparent and have adequate safeguards for legal recourse.**
Much of the Dutch legal framework has been aligned with EU framework legislation. Laws are easily accessible for the public, and recourse to civil and administrative courts is guaranteed by the Constitution and by lower legislation. Support for legal recourse is given to low-income citizens. The principle of "fair administration" in administrative law gives the judiciary substantial scope to adjudicate in favor of private parties even in cases that the government operates within the legal framework. On the other hand the highest administrative court, de Raad van State, or Council of State, is part of the Executive, and some critics have indicated that this position has predisposed it for adjudicating in favor of the Executive. In any case, the separation of powers with respect to administrative law is not so well defined as in other EU countries. The Netherlands has adequate legislation governing public access to government information through the so-called Law on Public Availability of Administrative Information *Wet Openbaarheid van Bestuur*.

6. **Relationships between government and public financial corporations are clearly defined, but include some quasi-fiscal activity.** *1.1.4*
Aside from the De Nederlandsche Bank (DNB), the Dutch State has equity holdings in eight financial companies. The most prominent of these are the Bank for Dutch Municipalities, the fifth largest domestic bank,[5] the Dutch Water Board Bank, and the Dutch Development Finance Corporation. While these medium-sized banks, and a number of other small state-owned development banks operate mostly in dedicated market segments, lending modalities have become fully market determined. The nondiversified client-base of these financial institutions does still imply some implicit subsidization for a public interest goal.[6] State-ownership of these banks also implies an implicit guarantee for their funding activities.

7. **Public ownership of the nonfinancial corporation sector is significant, but public interest is progressively being clearly separated from commercial operations.** *1.1.4*
The Dutch State had full or partial equity holdings in 42 companies employing more than 250 thousand people in 2004. The most substantial holdings, however, are partial holdings in largely privatized state-owned enterprises as KPN (19 percent), the Dutch Telecom company, TPG (18.6 percent), the former Dutch postal services, and KLM (14.1 percent), the former state airline. These holdings have been divested gradually, from the late nineteen eighties onwards, with the objectives of stabilizing the privatization process and maximizing returns.

---

[5] Owned 50 percent by central government and 50 percent by local governments and commercial banks. The Bank for Dutch Municipalities provides loans to local government, utilities, and public sector entities.

[6] Non-diversification leads to higher portfolio risk, and, thus, implies a public policy choice to accept below market rates of returns.

Ownership has been retained in a number of other companies, mainly those with a public interest role or those facing noncompetitive market conditions, such as, for example, the Dutch Railways, the regional bus company, and the National Energy Holding Company. The authorities' view is that companies with a public interest role, or in a natural monopoly position, are difficult to privatize without affecting the management of the public interest role, the price setting of services, or the quality of service delivery. Moving back towards full integration in the public sector is, however, not seen as desirable from the point of view of operational management.

8. **Public nonfinancial corporations carry out some quasi fiscal activities, but these are not always fully costed and presented in budget documents.** *1.1.4*
State-owned limited companies that operate in not-fully competitive environments and/or provide public services, are funded through (a combination of) regulated user fees, cross-subsidization by profitable activities, explicit subsidies, and cost compensation mechanisms for identified (loss-making) activities. The operation of the latter mechanisms through tender procedures is a great improvement in transparency as it produces a market price for provided loss-making activities. However, the combination of the various funding sources, for example in regional bus transportation, where an operational subsidy is combined with tendering of loss making routes, makes the full cost of subsidized activities difficult to determine. In addition, target rates of returns on investments and pay-out ratio's on profits for state-owned companies differ considerably from company to company, implying some scope for variable and implicit subsidies.

9. **Arrangements regulating profit transfers from state-owned enterprises are transparent, but policies could be clarified.** *1.1.4*
For a number of state-owned companies, such as the Dutch Railways, a target return on investment has been declared and presented to parliament by the MOF (of 7 percent). The basis for this target is unclear. Such targets vary to some extent from company to company, and the repercussions when a target is not met are not specified. In addition, pay-out ratios vary considerably. In a noncompetitive environment, it is unclear to what extent this variation implies an implicit subsidy.

10. **There is no formal legal framework for privatization, but processes and use of proceeds are reasonably transparent.** *1.1.5*
Larger equity holdings are mostly sold through the stock exchange, while smaller ones are transacted through tender procedures, or through bilateral negotiations. Revenue from equity sales is classified as a financing transaction. When state assets are sold, all proceeds go to the MOF Treasury, and such receipts used only for reduction of government debt. The resulting lower interest payments are applied to investment through the Fund for Structural Enhancement of the Economy (FES) (which is discussed further in paragraphs 18–20 below). Asset sales are presented and discussed in the budget documents and in a yearly annual report on the management of state assets. In this document all names of management and supervisory boards of state-owned enterprises are enumerated and their remuneration is presented, mainly on a per person basis.

11. **Mechanisms have been established to define and assess public-private partnerships (PPPs), but a legislative framework is absent.** *1.1.5*
To help establish clear rules and an independent review of potential alliances between government and the private sector, the government established the PPP Knowledge Centre, as part of the MOF in 1999.[7] The Advisory Council of the Knowledge Centre consists of experts drawn from the private sector in the Netherlands and abroad. It monitors PPP activities and makes recommendations to a PPP Steering Group, consisting of representatives of government departments. Since then a number of important investment projects have been designed, built and operated through PPP contracts, including the high-speed rail link to Brussels. The government does not think it is necessary to define a legal framework for PPPs. Current policy is to encourage development of expertise and specialized knowledge centers in the line ministries, as well as to encourage decentralized development of (relatively simpler) PPP arrangements by the municipalities. The MOF does not currently monitor PPP activity for the whole of government.

Government relations with the central bank and public financial sector

12. **DNB is independent and carries out no fiscal activities.** *1.1.4*
The DNB is the central bank of the Netherlands and, along with the other central banks of the European Monetary Union (EMU), it participates in the European System of Central Banks (ESCB) to set monetary policy for the Euro area. Its independence from government in this area is established under the protocol on the statute of the ESCB. Domestically, DNB's main roles are to promote the smooth operation of the payments system and to supervise financial institutions and the financial sector. Its duties are set out in the 1998 Bank Act.[8] The DNB is not the fiscal agent of government; government borrowing and debt management are carried out by the Dutch State Treasury Agency (DSTA), a directorate of the MOF. The DNB, however, maintains a close watch on economic policy and government fiscal policy. There are regular monthly meetings between the Governor and the Minister of Finance. It produces independent economic forecasts in June and December, which provide a useful comparison with those of the Netherlands Bureau of Economic Policy Analysis (CPB). It may, from time to time comment on government fiscal policy and one of its directors is a member of the Study Group on Budgetary Margin.

[7] See http://kenniscentrumppps.econom-i.com/uk/pps/kennis_intro.html. Guidelines on PPPs and procurement in the Netherlands are provided at http://kenniscentrumppps.econom-i.com/uk/pps/pdf/procurement.pdf .

[8] See http://www.dnb.nl/dnb/bin/doc/bankact1998_tcm13-36143.pdf for Bank Act 1998, Articles of Association of De Nederlandsche Bank N.V., and Statute of the European System of Central Banks, and of the European Central Bank.

Fiscal management relations among the branches of government

13. **The fiscal roles of the executive and legislative branches are clearly defined in law.** *1.1.2*
The powers of the branches of government are defined in the constitution, first promulgated in 1815, and amended many times since. The Kingdom of the Netherlands has been a constitutional monarchy since 1848. Minister and deputy ministers are not allowed to be members of parliament, implying a strong separation of powers between the executive and the legislature. The fiscal responsibilities of these two branches of government, as set out in the Constitution, are (i) the government is required to present to the two houses of the legislature an annual statement of policies to be pursued in the coming year on the third Tuesday of September (Article 65), and, under Article 105, to present the general estimates of revenues and expenditures at that time for enactment—requiring all spending to be authorized by law; and (ii) Article 104 requires taxes to be imposed under a law of parliament. The state budget is not enacted as one law. Every budget chapter is enacted separately (and defended by the respective line minister). Parliament has the right to vote an amendment to each appropriation item in any chapter budget, although ministers can decide not to implement these amendments.[9] Established parliamentary procedure requires that every budget amendment proposed must provide its source of financing through expenditure reduction or tax increase. Detailed obligations consistent with the constitution are set out under the budget system law (Government Accounts Act (GAA), 2001) and relevant tax legislation (each discussed further below).

Fiscal management relations among different levels of government

14. **The responsibilities of different levels of government are clearly defined.** *1.1.2*
Public administration in the Netherlands is three-tiered and consists of: the State, the twelve provinces and 489 municipalities.[10] The main tasks of municipalities are in the areas of

---

[9] At that point a minister risks a vote of no confidence. The upper chamber can only accept or reject the budget.

[10] The tasks, roles and responsibilities of provinces and municipalities are determined by two laws, the "Provinciewet" en de "Gemeentewet," respectively. Financial relations with central government are specified in the law "Wet Financiering Lagere Overheid." Each layer of government has its own responsibilities and its own, democratically elected administration. An overview of devolution and responsibilities is given in http://www.cor.eu.int/document/documents/paysbas_en.pdf. Main executive administrative responsibilities for overseeing intergovernmental relations lies with the Ministry of the Interior and Kingdom Relations, which has responsibility for (i) coordinating the legally determined division of tasks among the three layers of government; (ii) supervision of the implementation of legal requirements by local government; (iii) appointment of provincial governors and the mayors of municipalities; and (iv) coordination of cooperation between local government and other public authorities and administrative bodies, such as the water

(continued...)

provision of town services, social assistance, primary and secondary education, heath care, spatial planning, and housing development. Provinces mainly have responsibilities in spatial planning, environmental policy, and infrastructure development, and in supervision and coordination of municipalities.

15. **Municipalities are heavily dependent on central government grants**. *1.1.2*
The main sources of income for municipalities are: general grants (the level of which is tied directly to the level of central government spending)[11]; specific purpose grants; and own income (covering tax and nontax revenue, and asset or land sales). In 2005, general grants accounted for about 27 percent of local authority spending, specific grants accounted for 40 percent, the remainder came from own sources.[12] The high proportion of municipal income that comes from specific grants suggest that much municipal activity can be seen as implementing central government policy. A relatively new development is that specific grants leave options for local initiative.[13] In addition, the trend is for the proportion of general grants to increase relative to specific grants. Provinces are financed by general grants and by limited nontax revenues and levies. They are relatively small in terms of budget compared to the municipalities, and have mainly administrative oversight tasks.

16. **Allocation of the general grant among municipalities and provinces is determined by a number of objective criteria**.
These criteria are published in budget documents, and include such elements as number of inhabitants, the size of land and water areas, the number of houses, the size of the historic district, the population structure, and whether or not the local authority has a regional function. The weightings take into account different cost structures and aim to equalize services across municipalities. Provinces and municipalities have strong representative organizations that negotiate extensively with the Ministry of Interior and Kingdom Relations (Ministry of Interior). The Minster of the Interior represents the interest of local government in cabinet. The main municipal taxes are the property tax and the property transfer tax. Local authorities cannot influence the nature of these taxes as they have been enacted at the national level. There is some flexibility for municipalities in setting rates and determining

---

control boards. In addition, the Ministry of Interior coordinates relations with the Netherlands Antilles and Aruba.

[11] A reduction or increase in the level of central government spending will alter the grant by about 20 percent of the central government change.

[12] The general grants are channeled to local governments through two Funds, the "Provinciefonds" for the provinces, and the "Gemeentefonds" for the municipalities. The Funds are administered by the Ministry of Interior.

[13] For instance, specific grants for social assistance (run by the municipalities) is set in relation to unemployment levels and is independent of performance during the year. Though level of benefits and eligibility are set by national law, local authorities can determine the best way to utilize the grant in their area and can retain any surplus funds.

taxation value of real estate within overall parameters and guidelines determined by law. Part of the property tax (on use of dwellings) is to be taken over by the central government and compensated by an increase in the general grant.

17. **Financial supervisions of municipalities is delegated to the provinces, but gives insufficient insight in development of the EMU-deficit during the year.**
Both municipalities and provinces approve their own budgets. The next higher level of government is responsible for assessing the legality of the approved budgets and final accounts. Provinces have this role for municipalities and the Ministry of Interior for the provinces. Reporting on budget execution takes place through Statistics Netherlands on the basis of questionnaires. Until recently the response to these questionnaires and the quality of the data was insufficient. The delay in providing consolidated overviews to the MOF was up to six months, making reacting to unexpected movements in the EMU-deficit of lower government for the MOF virtually impossible. In 2004 agreements were made for substantially improving reporting of quarterly fiscal data of local government to Statistics Netherlands. These improvements are still in the process of being realized. In addition, regulation was recently passed, which will come in effect in 2006, empowering the MOF to impose borrowing limits and constrain investment expenditure of individual municipalities if general government as a whole is in danger of exceeding the 3 percent level for the EMU-deficit.[14]

18. **Municipal borrowing is subject to supervision by the provinces and indirect supervision of the Ministry of Interior and the MOF.** *1.1.2*
The latter two also supervise borrowing behavior of the provinces as part of the overall budget. Within specified prudential limits, municipalities can borrow for public purposes through the financial markets.[15] Borrowing is in practice only allowed for investment purposes. Refinancing risk is subject to prudential limits. Lending by municipalities must be guaranteed and is restricted to financial institutions with an A rating and other government institutions.

The legal and administrative framework for budget management

19. **The GAA gives a clear and comprehensive legal framework for management of public funds.** *1.2.1*
Reform of the legal framework for budgeting and accountability of policy has been a central feature of the broad-ranging fiscal and financial management reforms being implemented in the Netherlands from the mid-1990s. The GAA incorporates many important elements of

---

[14] This regulation would come into effect at a signal value of the EMU-deficit of 2½ percent of GDP.

[15] Maximum short-term debt of a municipality must not exceed 8–10 percent of the municipality’s total budget; long-term debt repayment must not exceed 20 percent of total long-term debt.

good public financial management: (i) a clear definition of the structure of the state budget, including separate chapter budgets for all line ministries, the public debt, and specified budget funds; (ii) prescription of comprehensive coverage by the budget of all parts of central government; (iii) identification of expenditures on a gross basis, i.e. including those expenditures funded by nontax revenues; (iv) a clear definition of the appropriation basis; (v) a requirement to present multiyear expenditure and revenues in the budget; (vi) a clearly defined timetable for the budget cycle; (vii) an obligation to identify new policies and their financial implication in the budget; (viii) an orderly budget amendment procedure; and (ix) a central role in fiscal, budgetary and public financial management for the Minister of Finance. The GAA covers many other aspect of public financial management. For example it specifies the role of the Court of Audit (COA) in detail, the responsibilities and accountability of ministers, the tasks of Internal Audit Directorates, and the relatively independent role of financial directorates of ministries (FEZ)**.**

20. **The GAA specifies the role of the Minister of Finance and of other ministers for financial management.** *1.2.1*
The Minister of Finance coordinates and guides budget and financial management processes over the whole of central government. His primary responsibility is the preparation of the State Budget and the management of the state debt. The coalition agreement and related expenditure frameworks in which real expenditure is fully planned for a number of years, adds further strength to the position of the Minister of Finance. The agreement reinforces budget discipline; claims of spending ministers can come only at the expense of the budgets of other ministers. The GAA covers only the financial management of central government and is supported by extensive budgetary regulations. The full implementation of these regulations is the responsibility of the line ministries and the MOF relies on departmental FEZ and internal and external audits for this task.

21. **The GAA limits the issuance of debt on behalf of central government to the Minister of Finance.** *1.2.1*
The Minister is also always at least a co-signatory on government guarantees. The GAA does not specifically address the issue of debt or fiscal sustainability. The Netherlands of course does adhere to the Maastricht Treaty which specifies quantitative limits on the stock of debt and the fiscal deficit.

22. **All government funds are on-budget, but further clarification of the policy framework with regard to gas revenues is required.** *1.1.3*
The state budget contains two budgetary funds through which gas revenues are channeled in support of additional public investment expenditure. The first of these funds, the FES, managed by the Minister of Economic Affairs, is a distribution fund which takes in yearly approximately 42 percent of net gas revenues of the Dutch State. Including taxes on gas sales, which also flow to the government, the share of gross gas revenues going into the Fund is approximately 30 percent. The other 70 percent is accounted for in the budget of the Ministry of Economic Affairs, while windfalls in this part during the cabinet term are used

for deficit reduction.[16] A large part of the FES resources are channeled to the second budgetary fund mentioned, the Infrastructure Fund, managed by the Minister of Transport and Waterworks, which uses these for multiyear investment projects.[17] Incoming gas revenues are, thus, spread out over multiple years. The FES Fund is a virtual fund in the sense that no financial assets are accumulated. Inflows reduce the EMU deficit in full in the year of inflow, and the deficit increases in subsequent years when expenditure is actually made. Since 1995 some 32 billion euros has been distributed through the FES, half of which still has to be implemented in the period up to 2010. The expenditure through the fund in 2005 is estimated at 2.1 billion euros, or around 0.4 percent of GDP. Aside from gas revenues, the FES receives, also, at present, funding from windfalls in interest payments caused by reduction of public debt through the sale of state equity holdings (net of reduced dividends), and the auctioning of broadcast–frequencies.

The legal and administrative framework for tax policy and administration

23. **The legislative basis for taxation is clear and comprehensive.** *1.2.2*
All taxes are soundly based in law and the policy basis for the laws is clearly explained.[18] The law is taken as the basis for defining the benchmark basis of taxation for estimation of tax expenditures, as described in the following paragraph. The Tax Plan presented to parliament in September each year along with the budget memorandum describes in detail proposal to change tax rates or to introduce new tax measures. More radical changes to amend existing law may be presented as separate bills at the same time. All such changes take effect from January 1 of the budget year. Tax incentive policy measures and effective tax rates by industry level are described in the explanatory memoranda. The prevalence and extent of discretion on exemptions permitted by law is described in the budget documentation, specifically with respect to the budgetary impact. Measures regarding tax

---

[16] The net gas revenues are treated as nontax revenues and are determined on the basis of a complex profit sharing arrangement between Shell, Exxon, and the Dutch state which originates from a "gentleman's agreement," "Herenakkoord," from the 1960s between the three parties, which has been amended and revised multiple times, but which in essence has (reportedly) remained unchanged.

[17] The Infrastructure Fund is also fed with resources directly from the Ministry of Transport and Waterworks' own budget. The Infrastructure Fund is the main planning mechanism for large-scale, multiyear infrastructure projects in the Netherlands.

[18] See http://www.minfin.nl/default.asp?CMS_ITEM=MFCR3713314F2708211D5BFFF00104B3FBE32, covering, for instance, *Revision of Taxation 2001*, describing in detail the objectives and structure of the Income Tax Act 2001, and *Taxation in the Netherlands*, MOF, 2005, a regularly updated brochure aimed particularly at providing information for international companies.

procedures, such as self-assessment, are described, and estimates of compliance and administration costs are quantified.

24. **Tax exemptions are considerable in number and are reported in the budget.** *1.2.2*
A benchmark in terms of the full application of the relevant tax legislation is defined for all taxes and tax expenditures are estimated in terms of the revenue foregone as a result of any departures from the benchmark to achieve specific policy objectives. The benchmarks have been described in occasional publications but not as part of the budget process, and some "gray areas" of definition remain.[19] The complete list of tax expenditures, including the aim, the estimated cost and the most recent evaluation report is published every year in the budget memorandum (Annex 5, in 2005). Table 1 below lists the five largest tax expenditures in the 2005 budget memorandum.

25. **Tax administration is clearly defined and well-coordinated with overall fiscal management.** *1.2.2*
The tax administration is consolidated under a single organization, the Tax and Customs Administration, but is organized regionally. The central policy unit is located within the MOF. All units are subject to management contracts to monitor performance against indicators, such as case backlog and levels of appeals and provision of information to taxpayers at specific times. Tax administration has integrated administration and systems to deal efficiently with all tax matters for clients through client coordinators. Large taxpayer units deal with all tax matters for large companies. Specialist Knowledge Groups are set up to investigate tax avoidance schemes and, after determination of the ruling, brochures are produced and made available to taxpayers and tax professionals. At present, a tax and social insurance number (SoFi-number) identifies each taxpayer in all fiscal and social security transactions and systems.[20]

[19] See "Tax Expenditures in the Netherlands," by L. van Ende and others, Chapter 6 in *Tax Expenditures—Shedding Light on Government Spending*, edited by H. Brixi and others, World Bank, 2004. Gray areas include personal income tax deductions for payments of mortgage interest and contributions to pension and early-retirement schemes, which are included as part of the benchmark rather than estimated as tax expenditures.

[20] In 2006, The SoFi-number will be replaced by a multifunctional Citizen's Service Number (BSN), administered by the Ministry of Interior. This number will help eliminate the need for duplicate submission of personal details. See http://www.minbzk.nl/persoonsgegevens_en/gemeentelijke/persberichten/burgerservicenummer

Box 2. FES and the Fiscal Framework

The FES is not included in the expenditure framework, rather it is seen as playing a role in dampening the impact of fluctuations in the gas price on the budget. At the start of the Coalition Agreement an estimate is made of expected gas revenues during the cabinet term, based on a estimate of the oil price (to which the price of gas is linked) derived from CPB's cautious scenario. Also at this time, the additional investment allowed by this resource envelope is planned into the multiyear budget estimates (but not in the expenditure framework) as additional public investment to strengthen the economy. Gas revenues have, however, proven to be very volatile, and the pressures to spend windfall revenues within the cabinet term have proven hard to resist. In recent years cumulative some 10 billion euros in windfall revenue has been distributed by the FES. This extra expenditure (of which part still has to be realized in the coming years) is allowed because FES distributions are not included in the expenditure framework.

A major part of the rationale is to use the resource revenue for asset creation rather than consumption. Directed spending of windfalls of high gas prices on infrastructure should help avoid their financing of consumption, and recreate the Dutch disease policies of the 1970s. The FES Fund projects are subjected to cost/benefit analysis by the CPB and selection of projects by committees of civil servants. Also projects are seen as part of larger strategic policy analyses. The original destination of FES expenditure towards "hard" infrastructure, however, has been broadened in recent years to educational, scientific research, environmental and other "softer" infrastructure," (including new school buildings for vocational education, innovation policy, air quality policy, and monument protection), which in 2005 will constitute about 50 percent of outlays. The additionality of the FES investments has also deteriorated through the so-called "FES-bridge" mechanism, which has substituted some 2.4 billion of ministry of Transport and Waterworks funding to the Infrastructure Fund with FES resources in the period 2000 to 2010. Another issue for consideration is that, given the correlation of oil prices with the pace of activity of the world economy, and the world economy with the heavily export-dependent Dutch economy, the FES funded expenditure may well be somewhat procyclical.

26. **Taxpayers' legal rights are well defined.** *1.2.2*
Taxpayers have access to appeal to an independent judiciary. When taxpayers want to give notice of appeal, they do this at first by asking the tax inspectorate to reconsider its decision. If this is declined, the next step is to seek mediation (including tax officials or outsiders at the choice of the taxpayer and the expense of the tax administration). Finally, taxpayers may take the appeal to court, with rights to go to higher courts. There is also a mechanism for requesting advanced tax (or customs) liability rulings on particular transactions. Questions on the interpretation of tax law in specific situations are addressed in "policy decisions" of the Secretary of State for tax affairs. International questions of Tax law are dealt with by rulings (the "ATA/APR-procedure"). Special efforts are being made to provide timely information to taxpayers. It is mandatory to publish all policy decisions on the internet.[21]

[21] It is proposed in the near future to establish individual call centers on the internet, where taxpayers will be assigned their own domain to enable them to seek advice or information on tax matters.

Table 1. The Netherlands: Major Tax Expenditures 2005

Tax expenditure	Aim of tax expenditure	Estimated Cost 2005 accrual-basis
Income tax: Tax deduction self employed	Stimulating entrepreneurship	€ 1177 million
VAT: reduced rate for food supply in the catering industry	Stimulation of tourism, reducing administrative burden	€ 1003 million
Income tax: general allowance on income on property	Avoid taxing of the first small amount of property-income	€ 869 million
Income tax: exemption on certain rights to payments out of capital insurance	No tax on savings in this capital insurance form. Capital saved must be used to lower the mortgage on own house.	€ 615 million
VAT: reduces rate for transportation of people (e.g. public transport)	Stimulation of public transport	€ 508 million

Public servants' code of behavior and anticorruption activity

27. **Public servants are subject to well-defined codes of behavior, but these are not uniform over government.** *1.2.3*

The Ministry of Interior has developed models for codes of conduct for civil servants in various sectors of government (ministries, local government, police, etc.). On the basis of this organizations have developed their own codes of conduct for their staff. The implementation of these is the responsibility of each individual ministry. Most ministries have appointed an integrity coordinator and perform integrity audits. Although inappropriate behavior in the civil service is at a very low level, evidence from various sources, including the COA, is that, in certain parts there has been somewhat of an increase. The quality of supervision by line ministry management is seen as sometimes lacking and variable across the civil service.[22] Moreover, these codes of conduct have been criticized for not giving much guidance on conflict of interest issues, scope for secondary employment, and for their nonuniformity across central government. The latter criticism is particularly relevant in the light of the ongoing process of developing a UK-style civil service in the Netherlands in which civil servants have become much less connected to individual ministries, but are seen as part of a civil service cadre (with much more mobility of staff between ministries).

[22] Judges, for example, have not been allowed to have remunerated secondary activities (above a certain level), but a recent stocktaking revealed that a considerable percentage still had paid secondary professional activities.

B. Open Budget Preparation, Execution, and Reporting

The budget preparation process: clarity and consistency of process and presentation

28. **The annual budget process is open and well structured.** *3.2.1*
The budget process splits decision-making on major reallocations and expenditure ceilings from the detailed discussion of line ministry budgets. This two-step budget preparation model has developed as best practice amongst Organization for Economic Cooperation and Development countries (OECD). The system sets expenditure ceilings per line ministry and budget chapter relatively early in the prebudget year, and then enables the MOF and line ministries to have in-depth discussions on reallocations within the set ceilings. From 1992, budgets have aimed at providing performance, as well as financial information. The budget preparation process provides ample time to line ministries as it starts in November of the year before the prebudget year. Another, commendable feature is the regular update of macro-projections by the CPB during budget preparation in the process of recalculating expenditure and revenue estimates by the MOF. In first instance this is done on an unchanged fiscal policy basis, but by June the CPB includes the agreed new fiscal policy measures. As the CPB also projects the expenditure and revenues of government for the medium term, this provides a valuable second-opinion on the projection of fiscal parameters. The main steps in the Dutch Budget preparation process are described in Box 3 below.

29. **The budget classification is structured to show policies and objectives under each budget chapter/line ministry.** *3.2.1*
The first layer of the budget structure is the classification by 25 budget chapters, 16 of which are line ministries. The second layer is based on policy areas or strategic objectives of the ministry in question. Appropriations are determined at this level. Below, this level the classification continues for planning and control purposes with layers specified by operational objectives (comparable to programs in other countries), “instruments,” and in some cases even lower layers identified by “activities.” Other parts of the chart of accounts consist of economic and functional classifications based on Eurostat’s ESA95 methodology. These classification are similar to and easily translated to GFSM 2001 nomenclature. The economic classification is used extensively for information, planning and control purposes, but is not used as an appropriation basis.

Box 3. The Budget Preparation Process in the Netherlands

The fiscal year is set on a calendar-year basis by the General Accounting Act. The year T is the budget year. The main steps are as follows:

Due dates	Activities	Legal basis
November T-2	Budget circular from MOF to line ministries to start internal preparations.	GAA
January/February T-1	Provisional “Central Economic Plan” provided by CPB to MOF and other ministries containing updated macro-projections for budget year and beyond.	
February T-1	Line ministries send policy letters to MOF indicating spending priorities + likely budgetary developments.	
March/April T-1	Preparation of recalibrated multiyear expenditure framework, with proposed shifts in allocations/cutbacks brought to cabinet by MOF, 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 chapter budget ceilings. Sent out by MOF to line ministers in “Totals Letter.”	GAA
May/June T-1	Detailed negotiations between MOF and line ministries on composition of their budgets.	
Early June T-1	Macrofiscal update provided in “Queen’s MEV” document by CPB to MOF and other ministries containing updated macro and fiscal projection and incorporating fiscal decisions reached by cabinet.	
June T-1	Parliament is informed on outline of next years budgetary plans and on budget execution in first quarter through the “Spring Memorandum.”	GAA
August T-1	Further fine-tuning of budget, both on expenditures and revenue side on basis of provisional Macroeconomic Outlook provided by CPB to MOF and other ministries.	
3th Tuesday in September T-1	Submission of State Budget and Tax plan to parliament together with CPB’s Macroeconomic Outlook document “MEV.”	Constitution
September T-1 December	Discussion of State Budget in Second and then in First Chamber of Parliament; First general political and macro-fiscal discussion, then individual chapter budget discussion, partly in parliamentary committee.	
Before end December	Approval by both Chambers of Parliament of all Chapter Budgets.	

The macroeconomic framework and policy basis for the budget

The main summary indicator of the fiscal position in the annual budget presentation is the general government EMU-balance. *3.2.3*
The relationship between budget estimates and the EMU-balance[23] is presented in the yearly budget memorandum and developments in the EMU-balance during the year are described in budget execution reports sent to parliament three times a year (Spring Memorandum, Budget, and Autumn Memorandum). The EMU-balance is also the primary indicator for reporting to EU when submitting the yearly Stability Programme (SP).

30. **Budget forecasts and underlying macroeconomic assumptions are clearly presented and updated during the year.** *3.1.3*
The most important macroeconomic forecasts underlying the budget, such as GDP-growth, inflation, wage increases, interest rates, exchange rates, oil prices and unemployment rates are routinely reported in the annual budget. These macroeconomic forecasts (and assumptions) are supplied by the CPB, which, as described in Box 4 below, is an independent government agency providing publicly available economic analyses to help guide the fiscal planning process (for more information see: www.cpb.nl). The "Medium-term Macroeconomic Outlook" of the Dutch economy looks four years beyond the first budget year for each cabinet period. These forecasts are an important basis for analysis of election platforms and formation of the new cabinet. Two medium-term scenarios are provided: one cautious, the other optimistic. As a matter of policy practice, the Coalition Agreements are normally based on the cautious scenario to limit the impact of economic setbacks. Within-year, the CPB publishes quarterly short-term forecasts of the domestic economy and the world economy looking at the current year and the next. More extensive analyses are presented twice a year: in March/April the Central Economic Plan (CEP) is published and on the third Tuesday of September the Macroeconomic Outlook (MEV) is published together

[23] With The Netherlands' participation in the Economic and Monetary Union (EMU), the government has accepted constraints to its fiscal policy as set forward in the Stability and Growth Pact. These constraints relate to agreed policy aims, such as a structural surplus over the economic cycle, and a maximum deficit level of 3 percent and of public debt of 60 percent of GDP. Related to these policy constraints, EU members are required to present their medium-term fiscal policy in yearly Stability Programs and report on actual deficit realization during the budget year on a quarterly basis. The EMU membership has, thus, forged a relationship between the domestic budgetary process and fiscal concepts defined in EU regulations. Most prominent amongst the latter is the general government deficit concept as defined in ESA 95. This deficit concept—referred to in The Netherlands as the EMU deficit -, is accrual based, although investment is treated as any other expense, that is no depreciation concept is used. Domestic fiscal and budgetary policy was and is largely based on cash accounting and focuses on central government. Obviously, the EMU fiscal constraints have required a translation between domestic and EMU fiscal concepts which is evident in budget documents and reporting.

with the government budget. The MEV and the Budget are consistent in assumptions on policy measures and economic forecasts. In June and December, CPB actualises its forecasts.

Box 4. The Role of the Netherlands Bureau for Economic Policy Analysis

The CPB was instituted in 1945 with the purpose of facilitating the central coordination of government policies and for advising on private sector production plans. Its role has evolved significantly since then, and it plays a crucial part in a number of different aspects of the design, implementation and evaluation of budgetary policy. The CPB is officially a part of the Ministry of Economic Affairs. Its broad functions are based on its governing law and supporting protocol, but its operational and technical independence is based on established practice and is recognized throughout the administration. Today the CPB provides forecasts of GDP growth and for a wide range of macroeconomic variables used by the government for budget preparation, and evaluation of the government's and political parties' economic policies. This practice is an integral and well-supported part of the policy-making process.

The CPB's medium-term macroeconomic forecasts, both before and after elections, are used by political parties to structure their economic policy programs. These projections also form the basis for the coalition agreements and the expenditure ceilings and revenue targets. The CPB evaluates individual investment projects, undertaking both feasibility and cost-benefit analysis. It also provides long-run sustainability analysis taking into account structural and demographic factors, as well as estimates of the growth potential. Decisions regarding the expenditure ceilings and fiscal targets are, however, taken by the democratically elected representatives and are not in the purview of the CPB. Nonetheless, it does assess the consistency between proposed policies and the expected fiscal outcomes. In all these respects, the CPB appears to span the full spectrum of activities identified in the recent IMF's analysis of independent Fiscal Councils.

Medium-term planning and analysis of fiscal risks

31. **Medium-term fiscal policy objectives of the budget are aligned with the framework agreement.** *3.1.1*

In the first budget memorandum of a new cabinet, at the start of its four-year term in office, the fiscal policy targets and medium-term framework implication for expenditures and revenues are discussed extensively. In subsequent budget memorandums during the cabinet term, the main lines of fiscal policy are reiterated and the evolving economic environment discussed. Each budget memorandum in following years, largely focuses on the budget year, but contains fiscal forecasts for the following four years in addition to the budget year. These multiyear expenditure forecasts are based on detailed information and each individual ministerial budget is linked to the fiscal policy objectives for the coalition period. The macroeconomic assumptions of these multiyear expenditure forecasts are revised only once or twice in four years when CPB provides medium-term forecasts.

32. **Fiscal sustainability is analyzed periodically, but is not highlighted yearly in the budget memorandum.** *3.1.1*

The budget memorandum provides all the relevant information but is not focused on fiscal sustainability or government debt, and thus, does not include targets for public debt or for the primary balance. As long as the balance is within the EMU limit, the coalition agreement negotiated in the beginning of the cabinet period contains the broad contours of policy and reforms to be followed over the four years. It also provides extensive details on the planned expenditure of line ministries. Sustainability requirements are important when setting medium-term policy targets in such an agreement. The current coalition agreement has explicitly linked expenditure ceilings and revenue targets to attaining a structural fiscal surplus of 1 percent of GDP at the end of the coalition period, which CPB has estimated is needed for public finances to be sustainable given the impending population aging. These analyses are sent to parliament and published in the public domain.

33. **Fiscal rules are used in the budget process.** *3.1.2*
The Coalition Agreement for each new cabinet includes fiscal rules derived from the trend-based budgetary policy introduced in 1994 (see Box 5). These rules are strictly adhered to and provide a high degree of stability in the budget process. Supplementary measures are only taken if the general government balance is in danger of breaching the EMU-limit.

34. **Estimates of new initiatives and ongoing costs of government policies are clearly distinguished in the budget documents.** *3.1.4*
The fiscal costs of new policy initiatives are separately identified in the budget process. Every ministerial proposition must be accompanied by a full overview of the budgetary consequences for all relevant years. Firstly, new proposals are scrutinized by departmental FEZ, and secondly, the financial implications are assessed by the Inspectorate of the Budget of the MOF before discussion in the cabinet takes place. An evaluation of policy impact and the specific role of government is required for each new policy measure. In practice this evaluation does not always takes place. After decision-making in the council of ministers, the budgetary effects, as well as the effects of changes in policy from previous years, are stated in the budget laws. All major cutbacks and increases in expenditures during the cabinet term are closely monitored in the Budget, and other budgetary documents, during the budget cycle.

35. **The sensitivity of budget estimates to changes in economic variables is assessed and fiscal risks are discussed in the budget**. *3.1.5*
The budget is based on the MEV published by CPB, which includes scenario's in macroeconomic key figures. The MEV 2006, for instance, assessed the impact of higher oil-prices on wages, inflation, economic growth, unemployment and the budget balance. These scenarios are often summarized in the Budget documents, together with a statement of the government's response to the risks involved. The budget may also report sectoral risk analysis, such as the budgetary risks in the health care system, or of new tax legislation.

Box 5. The Fiscal Framework in The Netherlands 1/

A basic principle of the fiscal framework is to anchor fiscal policy on predetermined multiyear expenditure ceilings and to let the automatic stabilizers play on the revenue side. The main elements of the framework include real expenditure ceilings for three subcategories of expenditures—central government, social security, and health—in addition to a ceiling on total expenditures. For each of the categories, as well as the aggregate, the ceilings are defined in *net* terms: that is gross expenditures minus certain nontax revenues. Savings in one category may be used to finance additional spending in the other two categories (although only in exceptional situations since 2002) and vice versa when spending overruns occur. From year-to-year, some carry over of overruns and shortfalls in expenditures can occur and to accommodate possible spending overruns reflecting contingencies, there is a small expenditure reserve included in the expenditure framework.

The expenditure ceilings cover both cyclical and noncyclical items, as well as interest outlays. However, part of spending on infrastructure investment (financed by the FES) is not included in the ceilings, nor is endogenous growth of tax expenditures (introducing new tax expenditures or changing existing ones is subject to the tax ceiling). In addition, local government spending is not covered by the ceilings (although general and specific grants, which constitute the bulk of local government funding, are included), but they are required, by law, to run balanced budgets over the medium term.

The expenditure ceilings are first set in nominal terms, at the start of a new coalition government, for each year of the government's presumed four-year tenure. They are converted to real ceilings initially using four-year inflation projections (using a domestic expenditure deflator), but are subsequently turned back to nominal each year using the latest forecast for the domestic expenditure deflator (before 2003 the GDP deflator was used). Thus, actual real expenditures can be tested against the initial real ceilings. The ceilings for each year are further revised in April of the given year on the basis of revised estimates of the deflator.

Cautious GDP growth projections are used in estimating a reference level of tax revenues (which in turn play a role in determining the expenditure ceilings). In the past, *ex post* deviations from these reference levels were treated as revenue windfalls (or shortfalls) to be used in part for (permanent) tax changes and for the rest for deficit reductions. To strengthen automatic stabilizers and improve the budget position, the revenue windfalls can now only be used for deficit reductions. This is a welcome change from the earlier period, 1999–2002, when windfalls were used according to a specific rule saying 50 percent of the windfall could be used for tax reductions when the deficit was less than ¾ percent of GDP, while only 25 percent could be used in the event the deficit was higher than this threshold. Revenue shortfalls were to be compensated by raising taxes by 25 percent of the shortfall when the deficit was less than 1¾ percent of GDP and 50 percent when the deficit was larger.

When deciding on the expenditure ceilings at the start of a coalition period—given the assumptions for revenues—the government relies on a benchmark for the required fiscal adjustment. Since 2000—but even before then—this benchmark is typically provided by the aging analyses of the CPB, that is, the government would normally aim for a (structural) balance by the end of the government period that is deemed consistent with a sustainable path for public finances, as calculated by the CPB. In line with an envisaged adjustment path meant to ensure fiscal sustainability, taking into account the fiscal costs of population aging, the authorities targets a structural surplus of 1 percent of GDP by 2007.

In order to improve fiscal discipline and avoid breach of the EMU-limit a signal value for the nominal balance was amended to the fiscal framework in 2003. Corrective action was to be taken if the actual deficit exceeded the signal value of 2½ percent of GDP. Were the latter to occur, every means was supposed to be used to reduce the deficit (both on the expenditure and revenue side)—and the agreed expenditure ceilings could , in this respect, be overruled.

1/ For detailed discussion, see the Netherlands: Selected Issues (IMF country reports No. 04/301 and No. 05/225).

Clarity of control of budget execution

36. **Well developed accounting and internal control procedures are in place.** *3.3.1*
The central government's accounting framework and internal control procedures are described in the GAA and in lower regulation. Each ministry has its own financial management system and is responsible for structuring its own business processes, but the MOF promotes, and if necessary regulates, the adoption of standard processes. The accounting system in general government is discussed further in paragraphs 43 and 63; for the central government accounts are on a cash/commitment basis. Some 39 government agencies and the ZBOs, however, operate on an accrual accounting basis, as do local governments. Accounting standards over line ministries and agencies, respectively, are uniform, and International Federation of Accountants—Public Sector Committee (IFAC-PSC) guidelines are observed in national accounting standards.[24]

Financial management practices are well developed. *3.3.1, 2.1.4*
Line ministries have invested substantially in strengthening internal controls, and financial management in general. In the early nineties there was a government wide initiative to strengthen administrative systems and controls. Since then ministries have continued to invest in staff capacity and system automation. Individual ministers and the FEZ directorates in each ministry are designated clear responsibilities for financial management processes by the GAA and underlying regulations. Clear rules for commitment and payment authorization and delegation are in place and provide an effective basis for internal control. Payments and commitments are recorded by line ministries, reflecting the substantial autonomy in financial management that line ministries enjoy. The MOF provides an extensive in-house training program to line ministry staff in budget and financial management skills through its Finance Academy. The COA is generally satisfied with the financial management standards in central government, which have improved substantially since the late 1980s.

37. **Cash and debt management practices are well coordinated.** *3.3.1*
Cash and debt management are carried out to some extent by separate institutional entities. The DSTA—based in Amsterdam, but a fully integrated part of the MOF—is responsible for all aspects of debt management, including development of the debt strategy, recording, reporting and servicing of the debt, and market operations. On the cash management side, cash planning is led by a cash management unit in the MOF, which is responsible for the payment operations system of the Dutch state. Market operations for keeping the balance of the State at the central bank between 0 and 50 million euros is, however, the responsibility of the DSTA. The separation of payments coordination and financial market operations is unusual for centralized treasuries, but has worked well in the Netherlands as it largely separates capital market and public sector activities in treasury management. It does require daily coordination of between both entities. Since payment authorization is fully

[24] IFAC-PSC has described broad guidelines for accounting standards in government covering both cash and accruals systems.

decentralized to the line ministries, the cash management unit in the MOF relies mainly on historical expenditure data and prenotification of large payments during the year. The system is not dependent on detailed reporting given the regularity of payments patterns and the flexibility on the money market for dealing with short-term adjustments. The treasury single account[25] is almost continuously held at a value of 25 million euros, which is a sign of the effectiveness of cash management.

38. **Debt management is based on a clear and regularly published strategy.** *3.3.1*
The DSTA develops the yearly issuance calendar and is responsible for debt operations, debt service, recording and dissemination of information on central government public debt. Its strategy is aimed at minimizing cost and risks over the medium term. A yearly report on Public Debt is published, while parliament is also informed on the public debt through a separate budget chapter through which parliament authorizes all debt service. Individual issue of government bonds is supervised by a committee headed by the Treasurer General in which the financial sector is also represented. All government debt is issued on the domestic capital market in euros. Foreign investors usually take up a considerable percentage of the yearly bond issuance. The maturity structure concentrates on medium- to long-term issues.

39. **Internal audit is effective, employs modern practices, and is gradually expanding its scope.** *3.3.1*
The GAA prescribes that each ministry has an internal audit department, which formally reports to the minister, although in practice the secretary general of the ministry is the main counterpart. The tasks of the internal auditors are to assess the regularity, orderliness, auditability and efficiency of financial and material management of the ministry and of all records kept for these purposes. Over the past few years, the internal auditor has started to expand in the direction of assessing effectiveness, efficiency, and value for money of the ministries' policies and policy implementation. Within the Performance budgeting system (VBTB) methodology, policy departments also have an important role in the 5-yearly cycle of policy evaluations. The COA is also developing expertise in this field. While internal auditors could usually provide useful analysis of efficiency issues, other countries have delegated the policy evaluation role to independent evaluation offices within the executive. Internal audit units report all their findings also to the COA and to the MOF's Central Audit Department. The latter ensures that the MOF is kept abreast of government wide issues and can formulate guidelines and regulations as needed. The recommendations of the internal audit units are in most cases incorporated by the secretary general in the yearly work plan of the ministry. The COA keeps track of this process and the effectiveness of internal audit.

---

[25] The Netherlands has a virtual treasury single account. Line ministries and agencies operate their own commercial bank accounts for expenditures and revenues transactions but these are zero-balanced with the government's main central bank account twice a day by the General Treasury's Cash Policy Department.

40. **Procurement rules are largely defined by EU regulations, but implementation has in the past sometimes proven difficult.** *3.3.2*
The EU framework, which applies to all procurement of general government above a minimum value (6.2 million euros for public works), provides ample safeguards for competitive bidding, expert evaluation and recourse to adjudication. Implementation is carried out by line ministries and other public entities independently. In the case of large scale infrastructure projects implementation has, on some occasions, proven difficult.[26] There is no national procurement office nor central MOF support for procurement processes. For the smaller, national procurements, a number of regulatory regimes exists, indicating less than optimum transparency for the private sector.

41. **Civil service employment procedures are clear and open.** *3.3.2*
The contractual relations of civil servants with their employer are regulated by a comprehensive law on the position of civil servants *Ambtenarenwet*. Most civil servants are employed through a competitive and publicly announced interview process for individual positions, although for young academics a Trainee-program has recently been initiated that attributes more importance to competitive examination. Policy departments within ministries have large discretion on staff selection, although for the more senior positions supervisory panels are established. Senior positions also require executive board approval. External application for such positions is encouraged—as is internal mobility during a government career. Promotion is determined on the basis of merit, not seniority. The General Civil Service Regulations (ARAR) and the Civil Servants' Pay Decree 1984 (BBRA) lay down in detail the requirements governing the appointment and discharge of civil servants. The legal framework provides adequate safeguards against discrimination, favoritism, and incompetence in selection and promotion procedures. In recent years, the ministry of interior has set up a separate section in the civil service for very senior staff, which loosens the ties to the individual ministry as an employer considerably. Instead the government as a whole has become the employer of these officials. Very broadly, civil service pay scales are seen as competitive at the lower levels, but less so at the higher levels. Pay scales from entry to midlevel, to senior are in a broad ratio of 1:2:3, in gross terms.

Clarity of internal control and independence of tax administration

42. **Tax administration has effective internal monitoring and control mechanisms.** *3.3.3*
There is an internal audit system in the tax administration to ensure financial accountability of tax collection staff and systems. For every tax office and every customs office internal audit procedures have been put in place to ensure financial accountability of customs collection staff and systems. For all personnel in tax administration a general code of conduct has been developed and applied.

[26] Collusion of construction companies has in the past proven difficult to tackle, as witnessed by the parliamentary investigation in "Construction Fraud."

43. **The national tax administration is given legal protection from political interference.** *3.3.4*
The tax and customs administration is part of the MOF's budget and is financed by annual appropriation under the budget law. The law setting up the Tax and Customs Administration provides legal assurance that the secretary-general has full authority to administer all tax and customs laws under his or her jurisdiction without fear of political influence.

Accounting and reporting on budget execution

44. **The accounting system produces accurate and timely in-year reports on central government budget outturn**. *3.3.1*
For internal use the MOF produces monthly reports on central government budget execution, including information on the EMU deficit. This reporting includes information on the health and social security sectors. A provisional report is available on the third working day of the month following the month being reported on. On the 15th working day a more definitive report is provided for which cash data has been reconciled with line ministry accounting data. This second report is used for fulfilling the IMF's SDDS requirements and is also published on the ministry's website. Consolidated reporting on local government is done by Statistics Netherlands on a quarterly basis, with a time-lag approaching three months after the end of the quarter. The quality of these reports is now being substantially improved. The central government fiscal reports can be produced according to the budget classification. Statistics Netherlands would be able to provide reports according to other classifications of the chart of accounts (with some lag). As noted, the budget classification is a combination of one organizational layer followed by four program layers. The chart of accounts further includes an economic classification based on ESA95, and a functional classification according to the United Nations classification of the functions of government (COFOG). The accounting system of the various line ministries records invoice dates; and so, budget arrears, if they occur, can be and are reported on. Payment arrears are uncommon, and citizens are paid an interest rate if they occur.

45. **Fiscal reporting covers central government, and, in consolidated form, local government.** *3.3.1, 2.1.1*
Fiscal reporting is on a gross basis, with no netting of nontax revenues. It also includes all in- and outflows to other governments and multilateral organizations, such as the EU. The budget classification of central and local government cannot be easily compared. The economic and functional classification used by Statistics Netherlands is, however, the same across general government. Local governments report in detail on their own budget execution, through in-year reports and in their final account, to their municipal council and their financial supervisors, including the MOF. This data is consolidated internally in the MOF, mainly for calculation of the local government share in the EMU deficit. Consolidated information on local government is presented at the national level in the budget of the Ministry of Interior. Fiscal data is also published by Statistics Netherlands which uses central and local government source data. Statistics Netherlands converts received data in national accounts-compliant form with only a short time lag.

46. **Parliament is provided reports on central government budget execution three times during the budget year.** *3.4.1*
The Spring Memorandum, published before the first of June, covers information up to March and is probably the most important focus for parliament on the ongoing budget. The budget memorandum, in September, looks very much towards the new budget, so the extent that budget execution is discussed can be limited. The Autumn Memorandum published before the first of December seems too late to effect any major expenditure changes at that time by parliament. The fiscal information provided in these reports is accompanied by explanations of discrepancies between budget outturn and budget.

47. **The audited final accounts of central government are available within five months after the end of the fiscal year.** *3.4.2*
Provisional accounts are sent to parliament before the first of March, while the National Annual Financial Report (FJR) is sent on the third Wednesday of May. The new Government Accounts Act stipulates this date and the government has tried in the past few years to reinvigorate the political discussion on the final account, with mixed success thus far. The FJR includes separate final accounts of all budget chapters, and is accompanied by the audit statement of the CAO. The FJR does not include final accounts of local government but does contain actual figures on the EMU-deficit provided by Statistics Netherlands. Only the transfers to local government, which are part of the central government budget, are presented and accounted for the FJR. After discussion and approval by parliament the documents are published.

Results-oriented budgeting, accountability, and reporting

48. **The objectives and expected results from government activities are clearly defined and an integral part of budget management.** *3.2.2*
The Netherlands introduced a form of program budgeting in 2001 (for the 2002 budget cycle) after a number of years of methodological development, and preparation and testing with the line ministries, starting in 1992. The so-called VBTB-operation was aimed at providing parliament a more policy-oriented and transparent budget document and connecting this with a policy-oriented final account. In addition, VBTB would enable government to focus on policy objectives, instruments, and inputs and outcomes in a more explicit manner. The methodology is centered round the policy budget structure and the so-called three “W” questions aimed at each budget activity: what do we want to achieve (policy), what are we going to do to achieve it (instrument), and what is it allowed to cost (expenditure). The final account was structured around the converse of these questions: have we achieved what we wanted, have we done what we planned to do, and did it cost what we thought it would.

49. **The new methodology has structured line ministry budgets around strategic objectives and related policy areas, which are then connected to performance targets.** *3.2.2*
Below this first layer of the budget structure, there are layers for operational objectives, instruments and activities. The MOF has provided guidelines on how line ministries should prepare performance indicators and targets for their strategic and operational objectives, and ministries have started reporting on them, both in the budget and in the final account. A recent

evaluation of the new system found that many performance targets are either subject to factors not under the control of ministries, not concrete enough, or not clearly linked to the amount of expenditure going into the policy area in question. The system has also led to a burgeoning of performance and evaluation reports. Also, with regard to transparency of the budget documents the evaluation revealed issues with regard to overload of information and unclear linkage between objectives, instruments and resources spent. In principle, and to some extent already in practice, the VBTB framework should be able to enhance clarity and focus of the budget documents and improve accountability through the similarly structured final accounts. parliament and COA have been supportive of the reform, as well as critical of its implementation. The recent evaluation has made a number of useful recommendations which are meant to focus and simplify the budget documents and the use of performance information. The goal of linking performance information to budgetary decision-making remains, however, is recognized as needing further development.

50. **VBTB has also introduced an enhanced approach to policy evaluation, but this has proven difficult to implement effectively.** *3.4.2*
Performance measurement was seen as inadequate to give a full assessment of the effectiveness and value for money provided by policy and policy instruments. VBTB now requires that five-yearly evaluations are prepared by each line ministry on all of its policy areas, and also on all new policy proposals. Even though these VBTB regulations have only been partly implemented by line ministries, they have resulted in a large number of policy evaluations of reportedly low quality, with a very limited impact on reallocation decisions. The recent VBTB evaluation signaled that line ministries were not well equipped for their evaluation task and that designating policy departments to evaluate their own policies raises doubts on the objectivity of the evaluations.

C. Public Availability of Information

The coverage and quality of budget and accounts documents

51. **The budget and final accounts documents cover central government fiscal activities comprehensively, and provide aggregate data on general government.** *2.1.1*
Fiscal data are presented in the budget in various formats, including the budget classification itself. The state budget sent to parliament contains the following sections: (a) a budget memorandum, in which the minister of finance presents an overview of the macroeconomic environment, the government's strategic policy priorities, and the fiscal and budgetary policy to support these. New policy initiatives and their related spending are clearly identified. The budget memorandum also contains overviews of various expenditure and revenue categories, deficit projections and borrowing requirements, the budgets of agencies, state guarantees, the multiyear implications of tax expenditures, a listing of "Large Infrastructure Investments," etc.; (b) connected to the budget memorandum is an extensive supplementary document presenting a description of each tax expenditure and summary multiyear estimates for all budget chapters at the appropriation level, as well as an analysis of all detailed changes in the multiyear framework since the previous budget; (c) some 25 chapter budgets, 16 of which are budgets of line ministries and the others on-budget budgetary funds. Defense expenditures

are reported comprehensively in the budget at the same level of detail as for other budget users. As indicated in the preceding section, final accounts data are presented in the same way as the budget, and are comprehensive and timely. The final account documents contain, in support of the VBTB framework, extensive information on the results of policy, the effectiveness of instruments, as well as the financial information on budget execution. The budget memorandum, individual budget chapters, final accounts, and other budget information including Annexes with even more information, can be downloaded, free of charge, from http://www.rijksbegroting.nl.

52. **Information on local and general government in the budget documentation is limited**. *2.1.5*
Financing of local government through general and specific grants is included in the Budget. Some aggregated data for municipalities and provinces is presented in the budget of the Municipal Fund and Provincial Fund, respectively. A more comprehensive document on municipalities in 2004 by the Ministry of Interior was discontinued. Statistics Netherlands compiles data on general government for regular reporting to Eurostat.

Past and forecast fiscal data in the budget

53. **The budget document discloses detailed information on spending for the year prior to the budget year and four years beyond the budget year.** *2.1.2*
All line ministries must provide information of the previous year's outcome on all budget items and changes compared with the last budget must be highlighted. A summary of this information is available to the parliament in the annex "Verticale Toelichting" of the budget memorandum. Aggregate information on the actual outturn of the budget deficit and the EMU balance for the previous twelve fiscal years is presented in Appendix IV of the budget memorandum. The information on the EMU-balance is divided between central government, social funds and local governments. Both past and prospective fiscal data, including information on public debt, is presented to the Commission through the yearly Convergence Programs. Eurostat collects budget execution data as part of its role in monitoring compliance with the Stability and Growth Pact.

Budget treatment of off budget fiscal activity

54. **A statement on contingent liabilities is included in the budget documents.**
An annex of the budget memorandum provides a summary on all government contingent liabilities by beneficiary and type of guarantee (credit, export, capital, liquidity, etc.). More details on the various guarantee programs or individual guarantees are provided in the chapter budgets. The estimated costs (due to called guarantees), and revenues (due to guarantee premiums received) for the budget year are also presented. An improvement could be to compare estimates of these figures with expected outcomes for the previous year. Budget estimates are mostly based on historical trends and insights in upcoming claims. No risk modeling or weighing seems to be used. Overall levels of guarantees are low at

12 percent of GDP,[27] but expected stock levels for the next year should be presented to indicate expected growth in various categories. The central government budget sets a yearly limit on new guarantees that can be provided (2.7 percent of GDP for 2006).

55. **Central government does not register PPP activities centrally, nor does it provide a assessment of total risk of PPPs.** *2.1.3*
PPP's had an unsuccessful start in the early 1990s, but are now in the process of being used more often, both at the central and local government level. As noted in paragraph 10 above central efforts on management of PPPs are being decentralized to line ministries and municipalities.

56. **Statements on tax expenditures are included in the budget documents.** *2.1.3*
The Annual Tax Expenditure Report (ATER) has been published in the budget memorandum since the budget year 1999 (Annex 5 of the 2006 budget memorandum). The report provides detailed estimates of the budgetary effects of tax expenditures for the preceding year, the budget year and the coming budget year. Medium-term estimates are produced for the following four years. The budget impact of introducing new tax expenditures or changing and abolishing existing ones are also reviewed.

Publication of data on debt and financial assets

57. **Information on public debt is comprehensive and easily accessible through publications and the internet.** *2.1.4*
The DSTA publishes an annual report on the realized borrowing, the existing debt stock, the debt management strategy of the government, and the outlook for the coming year. In addition quarterly outlook documents on in-year activity are produced. These documents contain a wealth of analytic information on the size and composition of the existing debt stock, the type of instrument to be used in future, the maturity structure, market liquidity, ownership, yields, spreads versus other debtors, and the issuance calendar. The MOF produces a separate budget chapter focused solely on the public debt, which presents this information also in a somewhat less technical format. The DSTA's website (www.dutchstate.nl) is very accessible and provides a wealth of information, useful both for the general public and market participants.

58. **Information on government financial assets is published regularly.** *2.1.4*
Financial assets of the state are fully presented according to ESA95 methodology in the central government balance sheet included in the Annual Report of the State (Annex 3, Table 3.7 http://www.minfin.nl/default.asp?CMS_TCP=tcpAsset&id=4F615A6E165847D0A177789D5255B93D).

---

[27] See budget memorandum 2006, page 98.

Commitment to timely publication of fiscal data

59. **Formal commitments for more regular publication of fiscal data have been made and advance release data calendars are announced**. *2.2.1, 2.2.2*
The Netherlands has subscribed to the IMF's Special Data Dissemination Standard (SDDS) and detailed "meta-data" are published on the IMF website on the type of fiscal data published by the authorities, the regularity and mode of publication. A considerable amount of fiscal data are regularly published on the MOF's website. Budget execution information is updated every month for the past month. As well as meeting the SDDS advance release date calendar requirement, there are domestic legal requirements to publish fiscal information during the year. In-year fiscal data are provided in the Spring (before June 1st) and Autumn (before December 1st) memorandums, and in the budget itself. Final accounts data are provided in the preliminary final accounts (before March 1st) and the FJR.

D. Assurances of Integrity

Integrity of data processes

60. **Budget data are reliable and the variance between budgeted and actual outturn of main fiscal aggregates is disclosed to the public, giving reasons for variation**. *4.1.1*
The actual outturn of gross expenditures deviated by 3 percent from planned expenditures on average in the previous three fiscal years (see data in Table 2 below). The deviation of net expenditures—which is the actual target under the expenditure framework—was 2.2 percent. As a consequence of a slowdown in economic growth the Dutch economy faced an unexpected decline in tax revenues in the last few years. While planned total revenues diverged on average by 4.3 percent from the actual outturns in the 2002–04 period, deviations in tax and nontax revenues were substantial in 2003, with tax revenues being some 7.4 percent lower and nontax revenue some 20.4 percent higher than expected. Interest payments were some 14 percent higher than expected both in 2003 and 2004. These rather high deviations point to a higher cyclicality of especially government revenues, as well as to the need to continue investment in high-quality tax forecasting methodology. Deviations between budget estimates and (planned and unplanned) deviations in outcomes are extensively explained in the supplementary budgets and in the state annual report. As noted above, supplementary budgets are used in a very orderly manner: two are submitted during the budget year (primarily to allow reallocation among budget chapters), and one together with the provisional final account in March.

Table 2. Revenues and Expenditures of Central Government, 2002–04
(in billions of euros)

	2002 Planned	2002 Actual	2003 Planned	2003 Actual	2004 Planned	2004 Actual
Total expenditure	125,7	131,4	132,8	136,7	134,3	132,0
Of which: capital expenditure	8,6	9,5	9,0	9,7	8,5	8,9
Of which: interest payments	10,4	13,0	10,6	12,1	10,0	9,8
Nontax revenues	18,6	19,7	17,6	21,2	17,4	17,5
Total net expenditures 1/	107.1	111.7	115.2	115.5	116.9	114.5
Tax revenues	110,9	105,0	112,1	103,9	106,5	106,2

Source: data provided by the authorities.
1/ Total net expenditures are calculated as total gross expenditures minus non tax revenues.

61. **Accounting policy is generally clearly defined but no formal statements are included in the budget and final accounts documents.** *4.1.2*
Since 1992 central government accounts are maintained on a cash-commitment basis, which is a form of modified cash accounting. The basic format of accounts is that of the budget classification itself (so-called "budget bookkeeping"). ESA95-format reports of government expenditure are compiled by Statistics Netherlands, and used ex-post by the MOF and line ministries. Detailed guidelines for central government bookkeeping are part of the handbook of regulations under the GAA. With the introduction of the agency model within central government in 1995, agencies were put on an accrual accounting methodology to enhance the efficiency of their operations and investment decisions. The (implicit) intention at the time was for the whole of government to switch to accrual accounting at a later stage. At present, the MOF has dropped its plans for the core central government to move to accrual accounting due to some reconsideration of the costs and benefits of such a move. A pilot for the future conversion of the ministry of Agriculture, Nature Management, and Fisheries is still in progress, however. ZBO's and local government have been using accrual accounting for much longer. The accounting norms used within local government and by ZBOs varied considerably in the past. The expectation is that the recently introduced new rules for budgetary accounting for local government will improve uniformity across local government. For ZBOs the accounting issues are complicated by the fact that their legal structure can vary.

62. **The use of two accounting systems by central government limits fiscal transparency to some extent.** *4.1.2*
For example, in-year detailed financial reporting by agencies and ZBOs and consolidation of their financial data is done less frequently then for the rest of central government, while connection of information systems has proven problematic. For expenditure control, as noted above, the issue is now less relevant as a number of ZBOs have been brought back into the

treasury system, i.e. they are not allowed to borrow or deposit funds outside the treasury. However, their expenditures are not registered under the expenditure ceilings used for budgetary policy. Most agencies have been brought back inside the State Treasury, which means that almost all central government cash transactions can be monitored continuously at an aggregated level. As noted, government accounting standards observe IFAC-PSC guidelines. Conversion to ESA95 and GFSM 2001 reporting standards takes place by Statistics Netherlands.

63. **The process of accounts reconciliation and fiscal reporting is effective, but could be modernized in the medium term.** *4.1.3*
Line ministry accounts are kept by respective FEZ directorates using own individual accounting packages. Accounting information is sent on a monthly basis through electronic file uploads (but in some cases still through manual input) to the MOF's core central government accounting system (KAKA). This information is reconciled with cash drawing (and receipts) accounts held for each central government entity at the central government treasury (excluding the smaller ZBOs). The reconciliation takes 15 working days to complete, and may suffer to some extent from loss of data integrity due to the fact that some ministries are not connected yet through electronic interfaces. Data reconciliations are shown explicitly in accounting reports. Because of the high-quality of budget preparation and dependability of budget execution by FEZ directorates, consolidated budget reporting, has not been the priority of the MOF and could be modernized further in coming years.

Independent oversight

64. **External audit is independent of the executive and legislative branches, and its mandate covers all central government public sector activities and emphasizes performance.** *4.2.1*
The COA is, under the constitution, independent of the government, having the status of a "high council of state," along with the lower and upper houses, the Council of State, and the National Ombudsman. The COA has a broad mandate under the constitution and the GAA to investigate whether public funds are collected and spent properly and effectively. It also audits compliance with the Netherlands' obligations under international treaties. It can determine, independently of the government and parliament, what to audit, how to carry it out, and what to publish. Every five years, the COA formulates and publishes its strategy for the forthcoming period.[28] In recent years, the COA has been heavily involved in examination, as well as encouragement of the VBTB program. In line with the objectives of this program, the emphasis of COA auditing has broadened from regularity audit to also encompass value for money or performance audit—the 2001 report was the last to have a purely regularity

---

[28] The 2004–09 strategy is described in the brochure "Effective and Transparent: Performance and Operation of Public Administration." See http://www.rekenkamer.nl/9282200/v/ .

emphasis. As indicated above, the COA is obliged under Section 83 of the GAA to report on the regularity of the FJR presented to parliament on the 3rd Wednesday of May.

65. **The COA audits the use of EU funds, both by central and local government, but does not have the mandate to track central government funds to the local level.** *4.2.1*
While the COA is authorized to follow EU funds down to the local government level, its authority, however, does not extend to perform regularity and performance audits on the use of central government general or specific grants at the local government level, unless so requested by the local government in question. Municipalities are required to set up their own Municipal courts of audit. In addition, they are required by law to be audited by private audit companies.

66. **Audit resources are broadly appropriate to the tasks.** *4.2.1*
The COA employs some 300 staff, most of whom are highly qualified professionals (more than 80 percent have graduate or higher degrees). The institution is headed by a three member board, (including a president). The board members are appointed by parliament, for life. The COA's budget is not determined by itself, but submitted to parliament through the Ministry of Interior and Kingdom Relations. Due regard is taken of the Court's special position, although when required, some sharing in cutbacks with central government is also practiced. The 300 staff complement is regarded as broadly adequate for the mandated tasks given that the COA works together intensively with the internal audit services of ministries, agencies and ZBOs. In most cases the regularity audit is done in full by the internal audit services, with the COA verifying the quality and integrity of these assessments. This approach has freed up considerable capacity for focusing on VBTB-oriented performance audits.

67. **The legislature discusses external audit reports, and follows up on audit findings.** *4.2.1*
The COA produces both audit reports aligned with the yearly budget cycle, as well as individual reports on specific policy and policy implementation issues during the year. The annual COA report now incorporates VBTB elements, but remains important for its assessment on the legitimacy, and correctness of budget expenditure and the quality of financial management systems. The topical audit reports are even more focused on performance issues. The COA always gives government opportunity to react to its draft reports and actually includes the government's position in its audit reports. The yearly COA reports are sent to parliament together with the government's FJR. The discussion on the annual report is done on the so-called "Accountability Day," on the third Wednesday of May, a day mirroring Budget Day on the third Tuesday of September. Discussions in parliament are in first instance held in full session, and subsequently by parliamentary committees dealing with the individual budget chapter reports. The COA keeps track of all its recommendations and updates parliament on the progress made with them in its annual report. The topical COA reports are sent to parliament when completed and are also usually followed by parliamentary discussion with the minister concerned or the Finance Minister (if government wide financial management issues are discussed). The COA has a special procedure for issuing warnings to ministers and informing parliament on issues of high

importance, or if systematically corrective action is not taken. The minister concerned is then obliged to provide a more formal explanation and presentation of his position and planned corrective measures.

68. **Independent scrutiny of macroeconomic models and assumptions is a well-established practice.** *4.2.2*

The practice that the government bases its budget calculations on CPB's macroeconomic forecasts enjoys wide support in Dutch society. CPB is independent within the executive, and seen to be so. Its projections and wider economic analyses are valued for their high-quality and objectivity. DNB, the central bank and some commercial banks also publish forecasts for the Dutch economy. This provides a good balance against a too dominant position of the CPB. Also, within the executive the CPB forecasts are discussed on consistency and assumptions, although the CPB has the final say on what it publishes.[29] The short-term forecasts are published in the CPB Newsletter and on the internet, accompanied by a short explanation. They are also presented in the two more formal CPB documents, the CEP, published in March and the Macroeconomic Outlook in September (presented alongside the budget). When preparing the short-term forecasts the CPB uses a publicly available quarterly econometric model. Every year CPB also presents the accuracy of its own previous short-term forecasts. The political parties from both sides of the political spectrum value the independence and quality of the CPB's activities. The practice has grown that all political parties subject their election program to evaluation by CPB on macro and fiscal impact. The legal framework for the CPB's independent position is not strongly developed, but rather is enshrined in the institutional culture and the result of nationally acquired respect for proven expertise. To strengthen the formal position, the present director has, in recent years, set up an independent Supervisory Committee to advise on the research agenda and quality of work. In addition, the CPB participates in international fora and invites on a regular basis an international evaluation committee to examine the CPB's activities. The reports of these committees are publicly available. As noted, additional assurance of independent macroeconomic analysis is provided by the DNB forecasts.

69. **The national statistics office is given legal and administrative assurance of independence.** *4.2.3*

Statistics Netherlands fulfils the task of collecting, processing and publishing national statistics for use by policymakers, the scientific community and the public at large. Previously a largely independent part of the Ministry of Economic Affairs, Statistics Netherlands became a ZBO in 2004, formalizing the de-facto independent position it had always held.[30] Statistics Netherlands has the responsibility to prepare and publish various statistics, including national accounts statistics, according to Eurostat guidelines and

---

[29] Except for extraordinary circumstances, for example when the government's negotiation position vis-à-vis third parties would be revealed on major issues.

[30] The law: "Wet op het Centraal Bureau voor de Statistiek," was enacted on November 20, 2003.

standards, and to provide these to Eurostat as source data. Statistics Netherlands' statistical programs are set by the Central Commission for Statistics. This is an independent commission that watches over the independence, impartiality, relevance, quality and continuity of the statistical program. At the national level, the Director-General of Statistics Netherlands decides autonomously on the methods to use to make the statistics, and whether or not to publish the results. It no longer is required to refer to the Minister of Economic Affairs. However, the minister is responsible for setting up and maintaining a system for the provision of government statistical information. The minister is also politically responsible for legislation and budget for the creation of conditions for an independent and public production of high quality and reliable statistics.

II. IMF STAFF COMMENTARY

70. **The Dutch fiscal management system has achieved a high degree of transparency.** Three elements in particular provide a solid foundation for sustaining transparent and accountable fiscal management practices: the technical reputation and political independence of the Netherlands Bureau for Economic Policy Analysis (CPB); the trend-based fiscal framework which establishes political agreement over expenditure ceilings and macroeconomic constraints over each cabinet period; and the integrity and independence of the Court of Audit (COA), the CPB, and Statistics Netherlands that collectively give assurance of sound financial data and management processes. Moreover, the administration has been consistently innovative in advancing its reform program, and is characterized by continuing self-analysis and adaptation as a result of experience and in response to a changing environment.

71. **Three main areas are seen as priorities for improving overall transparency and strengthening reform efforts**. First, the linkage of FES and tax expenditures with the fiscal framework could be clarified, and, at a more general level, more emphasis could be given to national accounts-consistent reporting. A second area where transparency could be enhanced is in local government finances in conjunction with the proposed framework of agreements with local authorities. Finally, the government should consolidate its impressive record of fiscal management reform by strengthening its capacity to provide strategic inputs and guidance to the decentralized reform process. In most cases, the transparency issues reviewed are already under active consideration, - for example, with respect to the fiscal framework through the Study Group on the Budget Margin, so the following assessments and comments are offered to stimulate further debate and suggest options for modification.

A. Strengthening Coverage and Consistency of the Fiscal Framework

72. **The fiscal framework and its clear linkages to national accounts concepts are a strong and generally transparent pillar of fiscal management**. There are three aspects, however, where a clearer disclosure of policies could improve transparency and further strengthen the framework. First, the FES would benefit from a reexamination and restatement of its rationale, its relationship to the fiscal framework, and a number of changes to its operations. Second, tax expenditures, which are transparently reported, could be more clearly linked to the fiscal framework. Finally, reporting on the budget and performance relative to the fiscal framework could be more clearly reconciled with national accounts standards as required under EU regulation.

The FES

73. **The FES has played a useful role increasing public investment and dampening the impact of gas price fluctuations on the budget**. However, the FES decreases the transparency of the framework to some extent, and, in recent years, expenditure control has been loosened due to transfers to the regular budget (the so-called FES bridge) and a broadening of project selection criteria. The FES has become a mechanism for public

investment allocation parallel to the regular investment processes of government ministries. Selection and prioritization of public investment are thereby made less transparent. Moreover, a substantial amount of windfall gas revenue has been made available for public infrastructure in this cabinet term, with relatively short lead times, leading to concerns with regard to quality of project selection. The timing of these investments could have had some procyclical effect on the economy.

74. **On balance, the mission considers that at this stage a separate fund remains desirable to reduce fluctuations in the budget and dedicate additional resources to high value investments.** However, the management of the Fund needs to be amended in several respects. The mission considers it desirable to continue earmarking a percentage of gas revenues for public investment through the FES, but to limit this expenditure to planned and costed investments at the start of a new Coalition Agreement given best estimates for gas prices. The fund should be allowed to accumulate windfalls and, conversely, absorb lower gas prices. Accumulated reserves should be maintained in the fund, invested in financial assets under clear investment rules (that should be published), and reserved for the next cabinet term. The expenditure plan at the beginning of each cabinet period should specify resources to be applied from FES to sectoral investment plans. An indicative sectoral allocation from the Fund should be done on a four-yearly cycle based on overall assessment of sectoral investment priorities and the availability of identifiable projects that are expected to achieve a high economic and social return. Allocation to projects should be integrated with line ministry procedures. Rigorous cost-benefit analysis should be employed on a uniform basis, and generally as part of a long-term planning cycle.

75. **In the first years of setting up the Fund, the balance of savings will be low and the possibility of insufficient resources could arise**. This uncertainty points to the necessity of starting the Fund, and the level of overall planned expenditure, on the basis of a conservative estimate of the gas price over the four-year cabinet-term so that surplus gas revenue can accumulate. If despite this, funds are insufficient, the use of other windfall revenues or expenditures for one-off, additional funding of the FES (up to the planned gas revenue level), could be considered. The Fund could, thus, provide for a useful destination of windfall revenues within the fiscal framework. Such windfalls have to some extent been a regular feature of the Dutch framework. These transfers should be the only interaction allowable between Fund and the fiscal framework. If no reserves and no windfalls are available, investment expenditure would need to be reassessed.

Tax expenditures

76. **Tax expenditures should be budgeted and reviewed in a way that is similar to direct spending under the expenditure ceiling.** By and large, the Dutch treatment of tax expenditures in the budget is aimed at integrating these measures with the overall fiscal framework and incorporates a five-year evaluation cycle for all tax expenditures. Introducing new tax expenditures or changing existing ones is subject to the tax ceiling. The system recognizes the special difficulties in targeting and controlling tax exemption targets. In many cases, data are not available to control all tax expenditures during the year in the same way as

direct spending. Moreover, there are difficulties in adding up tax expenditures in that the impact of each intervention is assessed on the assumption that all others remain constant. Such effects are not wholly absent in direct expenditure estimation, however, and this simply suggests that caution should be used in applying a tax expenditure ceiling—and that it should be separate from the direct expenditure ceiling. The mission considers that use of a separate ceiling for tax expenditures in the fiscal framework and a regular annual review of the tax expenditure outturn each year could increase overall policy transparency and be a useful supplement to the fiscal framework. Compensation within the ceiling should be done on a yearly basis only, to avoid in-year disruption of tax administration.

Broader application of national accounts standards

77. **National accounts standards for fiscal reporting, as embodied in ESA95, are fully adopted in the Netherlands**. ESA95 and its definition of the EMU deficit form a fundamental basis for fiscal reporting and the economic analysis of the CPB, Statistics Netherlands, the MOF and other bodies involved in macroeconomic analysis. In a number of respects, however, these standards are not applied consistently throughout government.

78. **Decentralized units of government should also comply with ESA95 fiscal reporting concepts.** Ministerial agencies, ZBOs, and municipalities all apply accrual accounting standards and their accounts focus on the net operating balance (including provision for depreciation of fixed capital). Nonfinancial assets are treated in the same way as financial assets in their accounting reports. Eurostat's ESA95 deficit definition, on the other hand, while also based on accrual concepts, includes investments in nonfinancial assets above the line, i.e. the net borrowing/lending balance. Essentially, this treatment applies a cash ceiling to such investment. It raises a number of issues about the financial reporting relation between units of government that operate on an accrual accounting basis and the core central government, which does not. These issues are discussed below for each type of unit. At a more general level, observance of EMU reference values for balances requires that all units of government be capable of monitoring their activities in relation to ESA95 concepts. As discussed below, the MOF should, regardless of the accounting framework, play a key role in ensuring consistent fiscal reporting standards across general government, to facilitate compliance with ESA 95.

79. **Another issue with regard to using ESA95 standards relates to the netting of some elements of nontax expenditure against expenditure in presentation and use of the expenditure framework**. While there are arguments for using net concepts to provide operational incentives to departments or agencies that recover costs by levying fees or charges, the areas where such netting is applied should be specified. Moreover, the nature of the process should be as open as possible by reporting gross, as well as net data and reconciling the framework explicitly with national accounts and budget presentation.

B. Clarifying Policies Toward Local Government and General Government Reporting

80. **Local government is highly dependent on central government for resources, but operates on accrual accounting standards for its investments**. At a micro level, the municipalities have clearly prescribed operating responsibilities and receive the bulk of their financing from central government general and specific grants, which constituted about 27 percent and 40 percent, respectively, of total municipal spending in the 2005 budget. The municipalities are required to balance their accrual-based operating budgets each year and have prudential limits on investment under the law on finance of decentralized government (FIDO) *wet FIDO,* as well as overall supervision by the provinces in the event of financial management difficulties. Within these limits, municipality investments are treated as commercial asset/liability transactions in their accrual accounts. The municipalities' contribution to breaching of the EMU balance limit of 3 percent in 2003 and their continued deficits since then have highlighted the need to maintain an overview of municipality finances in EMU terms. This essential monitoring could be best encouraged by requiring all municipalities to apply ESA95 coding to investment and other spending, and generate ESA95-consistent reports alongside their regular accrual reports. Such a change would both facilitate consolidated statistical reporting and heighten awareness of the EMU limits at all levels of government.

81. **Clarification of the implications of present financial arrangements in the context of EMU balance monitoring and possible transgression of the EMU signal value is required**. Application of EMU reporting will have considerable potential implications for municipal management. Many of these have been foreshadowed in the 2004 agreement between the government and local government representatives. However, further review is needed of the municipal financial and management arrangements in the context of macroeconomic policy imperatives. Key questions are: (i) to what extent will fiscal consolidated information be available in time for in-year adjustment of municipal deficits; (ii) are costs related to municipal retrenchment asymmetrically distributed over municipalities (according to timing of municipal investment programs); (iii) can provinces play an active role in coordination and transfer of deficit allocations; and (iv) will the present arrangement move municipalities to less transparent and more risky funding mechanisms.

82. **More emphasis could be placed on scrutiny of financial developments in the local government sector.** Given its importance for general government fiscal management, with over one third of general government expenditure being made at the local government level, more attention by the central government to these issues is warranted. The consolidated reporting and analysis on local government in the budget documentation is limited and should be improved in the coming years. The recently discontinued overview of the municipal sector by the Ministry of Interior could be reintroduced with inclusion of consolidated data on the provinces. Such a document could usefully be attached to the budget documentation.

83. **Another issue at the local government level concerns the auditing of the use of central government general and specific grants**. The mission has been informed that the

COA is not permitted to take initiative to investigate regularity and performance aspects of the use of these funds. Despite the municipalities' own commercial audit and the recently introduced office of the municipal auditor, it would enhance oversight if the COA were given a mandate to investigate the use of central government resources at the level where they are expended, at all times and at its own initiative.

A. Consolidating Financial Management Reforms

84. **The Dutch fiscal management reforms have been broad ranging and implementation has been rapidly decentralized**. Decentralized financial management has indeed traditionally been an integral part of budget management in the Netherlands. Decentralized implementation is seen as essential to achieving more efficient delivery of services. For a number of reforms, however, a certain tension is evident between, on the one hand, maintaining a strong sense of direction, uniformity and progress of reform and, on the other, allowing decentralized units to develop mechanisms that are most appropriate to their needs. The scope of the Dutch reforms means inevitably that there will be a range of levels of understanding and enthusiasm for reform among the various units of government. As problems arise, therefore, it is important to retain a strong central capacity to maintain an overview of progress and to provide advice or other forms of institutional structuring where needed. Clearly, overuse of such powers can have a negative effect. Areas where, in the mission's view, some further steps could be taken are: decentralized financial management and the role of FEZ directorates; implementation of VBTB; and application of the agency model. A reform area were further progress can be made without much coordination effort with other entities is that of tax expenditures and the analysis of contingent liabilities.

Decentralized financial management

85. **Decentralized financial management through FEZ directorates of ministries is well established and generally works very well.** The Netherlands has given a great level of financial management autonomy to line ministries, and underlying agencies and ZBOs. The MOF plays a well-developed role on macro-control issues, but on budget implementation and system development the role is more that of initiator, coordinator and knowledge provider. The capacities at the decentralized level in financial management are substantial, as is the automation of information systems. Also, the internal control and audit systems are modern and effective. Decentralization has had great benefits for flexibility, ownership and accountability for decentralized budgets. Links between the FEZ directorates and the MOF also remain strong and appropriate and it is essential that the position of FEZ directorates (as the main controller of line ministries) remain as independent as possible.

86. **FEZ directorates necessarily give more attention to parent ministry management needs than to broader reform objectives.** Though there are regular meetings between the MOF and FEZ directors, there are a number of areas where more could be done to enhance information flow, quality control and systematic guidance on fiscal management issues. These include complex budget processes, such as PPP, procurement, VBTB, policy evaluation, and EMU-balance monitoring.

87. **Continuing central support and direction appears necessary for management of PPPs, and perhaps for procurement processes more generally**. The MOF Knowledge Centre on PPPs has provided valuable guidance on assessment of PPP contracts, but no overarching regulatory framework is in place. The next steps appear to involve phasing out of the MOF Centre and delegation of PPP management to line ministries and municipalities. In the mission's view, a regulatory regime could enhance transparency of government policies and procedures and limit fiscal risk. It would also be appropriate for the MOF to set up a registry of PPPs and publish estimates of fiscal risk involved in budget documents. Similarly for procurement, the MOF should contemplate setting up a monitoring and capacity support function for large scale procurement processes, above a certain monetary value. This unit would track performance of procurement processes across government and provide guidelines for uniform application of the legal framework as needed.

88. **On policy evaluation, the standard requirement of a 5–yearly evaluation cycle is commendable, but implementation should be more strictly controlled and used as input for the budget process.** Presently, policy departments are responsible for evaluation of their own policies. The quality of these evaluations is reportedly low, and while outside experts are often requested to participate in them, there seems to be insufficient guarantees for independence of such evaluations. The authorities could consider setting up independent policy evaluation units either centrally at the MOF or at the line ministry level to enhance the quality and relevance of policy evaluations. In addition, the MOF should actively pursue the integration of the present policy evaluation process in the budget cycle, so that line ministry budgets are scrutinized more in-depth with use of this instrument.

89. **The MOF could provide stronger direction over national accounting standards to meet its macroeconomic balance monitoring objectives.** As noted in the preceding discussions on ESA95 reporting, the hybrid accounting system that operates for general government as a whole poses a number of difficulties in terms of delays in provision of information, and potential conflicts between different forms of financial management. Given the importance of ESA95 reporting, it would be desirable and seems technically feasible for present accounting systems throughout government to generate reports on an ESA95 basis, as well as their present cash or accruals basis. (Cash basis reports would continue to need timing adjustments for ESA95 reports).

Next steps on VBTB

90. **VBTB can, and in some instances has already, had a positive impact on the transparency of budget and final account documents.** Importantly, it has improved policy accountability and has the potential to improve allocative decision-making. The mission has the impression, however, that the "harvest" of these reforms has not yet been reaped, and that the MOF should redouble its efforts to coordinate and strengthen this reform. VBTB has resulted in budgets which link policies, activities, costs and desired outputs and outcomes in a logical way. The systematic use of both performance indicators and policy evaluations has enabled—in principle—both short-term fine-tuning of policy and policy implementation It

also permits a better assessment of medium-term impact and relevance of policies. The introduction of a special day for accountability deserves replication in other countries.

91. **VBTB has been subject to internal review and the MOF has a good understanding of the major weaknesses, and has appropriately addressed a number of them**. As many other countries have experienced, there are major difficulties in refining performance indicators and in integrating them effectively with budget decision making. The VBTB evaluation study of 2004 concluded that, while the structure of the budget has improved and the policy agenda clarified, transparency has been limited by excessive detail. In turn, these transparency weaknesses have reduced the impact of VBTB in improving allocative and operational efficiency. The study was also quite critical of the accessibility of budget documents. The mission concurs with the main conclusions that it is essential to keep the budget simple and focused on the main issues, limit the use and complexity of performance indicators to areas where they were relevant, and shift in-depth policy analysis to documents which are sent to parliament outside the budget cycle.

92. **Central efforts to support VBTB should continue to be emphasized**. While the mission agrees with the main lines of analysis, and a number of recommendations from the evaluation, it is concerned that efforts on further reform of the system may lack sufficient central direction. Performance budget reforms take a long time wherever they have been introduced, and establishing effective indicators of performance is a time-consuming task. Spending ministries do not always have the incentives or the skills to establish high quality performance indicators. It is essential, therefore, that the MOF continue to provide active guidance to ministries with regard to determination of appropriate performance information, linkage of performance targets to budget allocations and restructuring of budget documentation. It should also intensify efforts to use VBTB more extensively at both the political and the operational level to inform policy and policy implementation. The MOF is also in the best position to take advantage of the extensive experience in these areas from other OECD countries.

The agency model

93. **The agency model, while in many respects successful in improving efficiency and effectiveness, is in need of review and consolidation.** This process could best be guided by the MOF on the basis of transparent and uniform criteria, in consultation with spending ministries. The main problems facing policy towards departmental agencies and ZBOs (which represent a variety of agency models) are: (i) a lack of clarity on the appropriate balance between line ministry control and need for policy flexibility, on the one hand, and independent and efficient implementation, on the other; (ii) a need to coordinate the cash-basis budget decision-making and reporting systems of line ministries with decision-making and reporting on an accrual basis by agencies and ZBOs; and (iii) establishment of an effective process (based on uniformly applied criteria) for either reintegrating ZBOs back into line ministry structures, placing them outside of central government, or retaining their present (perhaps modified) status.

94. **Setting limits on the agency model will require more effective aggregate monitoring, coordination, and guidance by the MOF**. With respect to establishing clear criteria for creation of ZBOs, government action to re-examine existing ZBOs and set tighter criteria for creation of new ones is appropriate. The priorities now are for the MOF to ensure their consistent and effective application across government and reach an agreement with the line ministries on a timely reexamination process.

95. **Coordinating cash-basis reporting both for departmental agencies and ZBOs is important for effective monitoring of the EMU deficit**, but imposition of cash limits is likely to be costly in terms of operational efficiency—the primary reason for adopting the agency model and accrual accounting. Effective and timely reporting is essential to minimize disruptive adjustment processes at both aggregate and individual agency level. For ministerial agencies, which are already required to report to their ministries and maintain bank balances through the Treasury, coding all transactions in ESA95-consistent terms to provide more timely reports should be feasible. The task will be more difficult for ZBOs (as for municipalities) because many of the smaller ZBOs do not carry out banking operations through the Treasury. The possibility of establishing effective regular voluntary reporting on a quarterly or monthly basis by all ZBOs should be investigated as soon as possible. Efforts to establish uniform ESA95 standards for government should be very helpful in this regard. Where appropriate, ZBOs' financial transaction should be included in the treasury payment system.

Tax expenditures

96. **Tax expenditure reporting compares with OECD best practice standards, but could be developed further.** The tax expenditure information included with the budget documents in recent years provides a clear statement of costs and objectives of defined tax expenditures. Some further effort could be made, however, to present the costs of structural elements that are deemed not to be tax expenditures but rather are an integral part of the tax structure. As there is no universally accepted methodology to determine whether particular tax structures are tax expenditures, a number of OECD countries publish costs of such structural elements as part of the tax expenditure report.[31] This practice means that elements, such as deductions for mortgage interest payments[32] and pension contributions, which are not regarded as tax expenditures, but nonetheless constitute a distinctive, quantifiable structural element, are separately identified.

---

[31] The United Kingdom, for instance, publishes tables showing tax expenditures and "structural reliefs," the latter being considered part of the tax structure, while tax expenditures are seen as being potentially substituted by direct subsidies. Australia provides a relatively complete description of the benchmark structure for each tax.

[32] With respect to mortgage interest deductions, it can be argued that these are part of the cost of earning the imputed rent income from home ownership, which is taxed in the Netherlands. Disclosure of such elements provides additional information on the tax benchmark structure.

III. Summary Tables

Table 3. A Summary Assessment of Practices

Code Reference	Summary Assessment	Comment
Clarity of roles and responsibilities		
1.1.1	General government is defined consistently with Government Finance Statistics (GFS) principles, and is well covered in the budget process. Local government budgets are not included in a consolidated budget, though financing through general and specific purpose grants is included.	An annual summary report on local government finances could broaden the overview on general government.
1.1.1	Ministerial agencies have been used to provide a more effective and accountable mechanism for service delivery, but have made government reporting more complex. Aggregate reporting of nondepartmental agencies on an ESA95 basis is not yet sufficiently well integrated for timely tracking of the EMU deficit.	A case by case evaluation on reintegration of nondepartmental agencies (ZBOs) is underway. Reintegration into the Treasury has already mostly taken place.
1.1.1	Nondepartmental agencies, ZBOs, have a wide range of mandates, and concern has risen on their governance and financial accountability.	The evaluation of ZBO's will also examine the ministerial relationship and other governance issues.
1.1.2	The fiscal roles of the executive and legislative branches are clearly defined in law. All government expenditure is authorized by law.	
1.1.2	The responsibilities of different levels of government are clearly defined. Municipalities and governments are heavily dependent on central government grants.	
1.1.2	Allocation of the general grant among municipalities and provinces is determined by objective criteria.	
1.1.2	Financial supervisions of municipalities is delegated to the provinces, but gives insufficient insight in development of the EMU-deficit during the year.	
1.1.2	Municipal borrowing is subject to supervision and prudential limits.	
1.1.3	All government funds are on-budget, but further clarification of the policy framework with regard to gas revenues is required. Ad-hoc used of gas revenues to alleviate spending pressures should be resisted.	The FES should be more clearly linked to the fiscal framework, including by making explicit maximum sectoral allocations for each cabinet period, with windfall gains allowed to accumulate and kept in reserve for the next cabinet term.
1.1.4	Laws governing private sector activities are generally transparent and have adequate safeguards for legal recourse. The separation of powers with respect to administrative law could be more clearly defined.	
1.1.4	Relationships between government and public financial corporations are clearly defined, but include some quasi-fiscal activity.	
1.1.4	Public ownership of the nonfinancial corporate sector is significant, but public interest is progressively being clearly separated from commercial operations. Public nonfinancial corporations carry out some quasi fiscal activities, but these are not always fully costed and presented in budget documents.	The introduction of cost compensation mechanisms in tender procedures is a great improvement in transparency as it produces a market price for tendered loss-making activities

Code Reference	Summary Assessment	Comment
1.1.4	Arrangements regulating profit transfers from state owned enterprises are transparent, but policies could be clarified.	
1.1.5	There is no formal legal framework for privatization, but processes and use of proceeds are reasonably transparent.	
1.1.5	Mechanisms have been established to define and assess public-private partnerships (PPPs), but a legislative framework is absent.	The MOF should continue to provide policy guidance for and monitoring of PPP activity for the whole of government .
1.1.5	The central bank is independent and carries out no fiscal activities. Its macroeconomic projections and input for fiscal policy deliberations provide a useful counterbalance to the CPB	
1.2.1	The Government Accounts Act (GAA) gives a clear and comprehensive legal framework for management of public funds, and assigns overall fiscal management responsibility with the Minister of Finance	
1.2.1	The CPB's independent and central role gives an exemplary model for separating political and technical elements of macroeconomic policy.	
1.2.1	Line ministries have substantial own responsibilities for financial management with accompanying accountability.	MOF should remain cognizant of the need for monitoring, methodological guidance, and uniform implementation of complex PFM instruments as VBTB, PPP's, policy evaluation, procurement, and EMU-balance monitoring
1.2.1	The GAA appropriately limits the issuance of debt on behalf of central government to the Minister of Finance.	
1.2.2	The legislative basis for taxation is clear and comprehensive.	
1.2.2	Tax exemptions are considerable in number but are fully on reported in the budget.	Tax expenditures should be budgeted and reviewed in a way that is similar to direct spending under the budget ceiling,
1.2.2	Tax administration is clearly defined and well-coordinated with overall fiscal management. Taxpayers' legal rights are well defined.	
1.2.4	Public servants are subject to well-defined codes of behavior, but these are not uniform over government, while monitoring could be improved.	
Public availability of information		
2.1.1	The budget and final accounts documents cover central government fiscal activities comprehensively, and provide aggregate data on general government.	
2.1.2	The budget document discloses detailed information on spending for the year prior to the budget year and four years beyond the budget year.	
2.1.3	A statement on contingent liabilities is included in the budget documents.	Inter-year comparison of expected costs and of stocks should be included in the budget documents
2.1.3	Central government does not register PPP activities centrally, nor does it provide a assessment of total risk of PPPs.	Keeping a central registry of PPP's would be essential for monitoring fiscal risk.
2.1.3	Statements on tax expenditures are included in the budget documents.	Some further effort could be made to present costs of structural relief elements, such as mortgage interest rate deduction, included in the tax baseline.

Code Reference	Summary Assessment	Comment
2.1.4	Information on public debt is comprehensive and easily accessible through publications and the internet. Information on government financial assets is published regularly.	
2.1.5	Information on local and general government in the budget documentation is limited.	A comprehensive document on local government finances could be developed and included in the budget documentation.
2.2.1	Formal commitments for more regular publication of fiscal data have been made and advance release data calendars are announced.	
Open budget preparation, execution, and reporting		
3.1.1	Medium-term fiscal policy objectives of the budget is aligned with the coalition framework agreement. The Dutch medium-term expenditure framework is a state-of-the art instrument for planning and stabilizing government expenditures.	
3.1.1	Fiscal sustainability is analyzed periodically, but is not highlighted in the Budget Memorandum.	
3.1.2	Fiscal rules are used in the budget process, both within the Executive and in the budget discussion with parliament.	
3.1.3	Budget forecasts and underlying macroeconomic assumptions are clearly presented and updated during the year.	
3.1.4	Estimates of new initiatives and ongoing costs of government policies are clearly distinguished in the budget documents.	
3.1.5	The sensitivity of budget estimates to changes in economic variables is assessed and fiscal risks are discussed in the budget.	
3.2.1	The annual budget process is open and well structured with an early setting of line ministry budget ceilings in the pre-budget year.	
3.2.1	The budget classification is structured to show policies and objectives under each budget chapter/line ministry.	
3.2.2	The objectives and expected results from government activities are clearly defined and an integral part of budget management.	
3.2.2	The new performance budgeting methodology, VBTB, provides an excellent opportunity for increasing transparency and effectiveness of government, but the full benefits of the new methodology still have to be reaped. Information is excessive, unfocused, and methodological not uniform across line ministries.	A recent evaluation called for a more focused use of performance information. Uniformity in approach and use in the budget process needs to be strengthened. Continuing support from the MOF should be given to achieve this end.
3.2.3	The main summary indicator of the fiscal position in the annual budget presentation is the general government is the EMU-balance.	
3.3.1	Well developed accounting and internal control procedures are in place in line ministries and agencies.	
3.3.1	Financial management practices are well developed.	The COA is generally satisfied with the financial management standards in central government, which have improved substantially since the late 1980's.

Code Reference	Summary Assessment	Comment
3.3.1	Cash and debt management practices are well coordinated.	
3.3.1	Debt management is based on a clear and regularly published strategy.	
3.3.1	Internal audit is effective, employs modern practices, and is gradually expanding its scope.	
3.3.1	The accounting system produces accurate and timely in-year reports on central government budget outturn.	
3.3.1	Fiscal reporting covers central government, and, in consolidated form, local government.	Decentralized units of government and local authorities should also comply with ESA95 fiscal reporting concepts, and the MOF should help by implementing consistent national reporting standards across government.
3.3.2	Procurement rules are largely defined by EU regulations, but implementation has in the past sometimes proven difficult.	
3.3.3	Civil service employment procedures are clear and open.	
	Tax administration has effective internal monitoring and control mechanisms. For all personnel in tax administration a general code of conduct has been developed and applied.	
3.3.4	The national tax administration is given legal protection from political interference.	
3.4.1	Parliament is provided reports on central government budget execution three times during the budget year.	
3.4.2	The audited final accounts of central government are available within five months after the end of the fiscal year.	
3.4.2	The use of policy evaluations has been strengthened in recent years, but remain difficult to implement effectively. Too many evaluations are produced with little or no impact.	More needs to be done to enhance quality, independence, and use in the budget process of policy evaluations. Continuing central support by the MOF is required.
Assurances of integrity		
4.1.1	Budget data are reliable and the variance between budgeted and actual outturn of main fiscal aggregates is disclosed to the public, giving reasons for variation.	Tax revenue forecasts are inherently difficult to make during changes of the economic cycle, but continued investment in high-quality tax forecasting methodology is necessary.
4.1.2	Accounting policy is generally clearly defined but no formal statements are included in the budget and final accounts documents.	
4.1.2	The use of two accounting systems by central government, for government department and for nondepartmental agencies, limits fiscal transparency to some extent.	Most agencies have been brought back inside the State Treasury, which means that at least central government cash transactions can be monitored continuously at an aggregated level.
4.1.3	The process of accounts reconciliation and fiscal reporting is effective, but could be modernized in the medium term.	In-year budget reporting, has been less of a priority of the MOF given the excellence in budget preparation. It should nevertheless be modernized further in coming years.

Code Reference	Summary Assessment	Comment
4.2.1	External audit is independent of the executive and legislative branches, and its mandate covers all central government public sector activities and emphasizes performance.	
4.2.1	The COA audits the use of EU funds, both by central and local government, but does not have the mandate to track central government funds to the local level.	An expansion of the COA's mandate to the local level would seem considering given the importance of domestic central government transfers.
4.2.1	Audit resources are broadly appropriate to the tasks.	
4.2.1	The legislature discusses external audit reports, and follows up on audit findings. The introduction of "Accountability Day" to report extensively on the annual account is a very noteworthy innovation that could be copied in other countries.	
4.2.2	Independent scrutiny of macroeconomic models and assumptions is a well-established practice.	
4.2.3	The national statistics office is given legal and administrative assurance of independence.	

Table 4. Public Availability of Information—A Summary

	Budget and fiscal report element	Included in budget/report documents	Available to the public	Para. ref.	Code ref.
1.	Central government (CG) budget estimates	Yes	Yes, published/provided to press/ put on internet	53, 55	2.1.1
2.	CG Defense Expenditures	Yes	Yes	53	2.1.1
3.	CG EBFs (including special development funds, social security funds, resource revenue funds)	Yes	Yes.	1, 22	2.1.1
4.	CG Budget outturns	Yes, in National Financial Account and in Budget documents In full detail for past year; somewhat more aggregated for earlier years	Yes	55	2.1.2
5.	CG Budget forecasts	Yes, in aggregate in two annual CPB publication, in detail in budget documents; 4 years past budget year	Yes, CPB and budget documents fully published	31,55	2.1.2
6.	CG Contingent liabilities	Yes, included in annex of Budget Memorandum. Probable cost is estimated and provisioned for in budget	Yes.	56	2.1.3
7.	CG Tax Expenditures	Yes, included in annex and supplement of Budget Memorandum. All tax expenditures, narrowly defined, included. Cost estimated, multi-year overview provided. Methodology explained in broad terms.	Yes	58	2.1.3
8.	CG QFAs	Partly. Use of costing mechanisms for QFAs on the increase.	Not systematically.	8	2.1.3
9.	Macroeconomic assumptions	Yes, in CPB and budget documents	Yes	31	3.1.3
10.	Analysis of fiscal risks/sensitivity analysis	Yes, in CPB and budget documents Costs/Risks are estimated, quantitatively if possible.	Yes	35	3.1.5
11.	CG Debt	Yes, in Budget Memorandum, budget chapter on public debt, and in extensive and high-quality documentation of Debt Management Agency. Includes information on debt composition, ownership, maturity, liquidity, etc.	Yes, information also available on internet	59	2.1.4

	Budget and fiscal report element	Included in budget/report documents	Available to the public	Para. ref.	Code ref.
12.	CG Financial Assets	Yes, in National Annual Financial Report (FJR).	Yes	60	2.1.4
13.	Sustainability Analysis	Yes, done in-depth on a regular basis by CPB and Finance; not yearly in Budget Memorandum; includes pension and social security schemes	Usually in CPB or MOF publications in preparation for new Cabinet	33	3.1.1
14.	General government budget estimates	No consolidated general government budget; estimates made of general government EMU-deficit in budget documents, for the medium term. Central government budget includes presentation of social funds, tax expenditures, and contingent liabilities	Not applicable	54, 56, 58	2.1.5
15.	CG Monthly/quarterly reports on fiscal outturn	Yes, monthly budget execution reports on internet. Three reports to parliament on budget execution: Spring Memorandum, Budget Memorandum, and Autumn Memorandum. Reconciliation of cash and accounting data in 15 working days after the month in question.	Yes	48, 61	3.4.1
16.	General government Monthly/quarterly reports on fiscal outturn	Yes, in-year consolidated general government reporting is done by Statistics Netherlands Time delay is being brought down to 3 months; data quality is improving.	Through publications of EMU-deficit by MOF and national accounts by Statistics Netherlands	55	3.4.1
17.	CG Final Accounts	Yes, FJR sent to parliament in May, together with Audit Report COA; all line ministry budgets separately audited.	Yes	69	3.4.2
18.	Consolidated general government Final Accounts	No, consolidated general government final accounts prepared	Not applicable		3.4.2

INTERNATIONAL MONETARY FUND

KINGDOM OF THE NETHERLANDS—NETHERLANDS

Suggestions Regarding the Fiscal Framework

Aide-Mémoire*

December 21, 2005

Revised March 3, 2006

* The Aide-Mémoire was prepared by an IMF team consisting of Messrs. M. S. Kumar (head), W. Allan, M. Skaarup, and H. van Eden, which visited the Hague from December 6-21, 2005.

Introduction

The Netherlands adopted its current trend-based expenditure framework as its main tool for budgetary policy in 1994. It is anchored by multiyear real expenditure ceilings and provides scope for automatic stabilizers to play on the revenue side, subject to keeping the general government deficit below the EMU deficit ceiling. The framework is set with reference to a target for the structural fiscal balance based on longer-term budgetary sustainability considerations. The framework is unique in many respects, and its design and implementation are highly commendable. The authorities' strong commitment to implement the framework, underpinned by the Coalition Agreements, has played a pivotal role in enhancing fiscal discipline, and in reducing tax burdens. In this process, a variety of institutions, most notably the independent Netherlands Bureau of Economic Policy Analysis (CPB), have played, and continue to play, a crucial role. At the same time, the analyses and assessment of the four-yearly Study Group on the Budgetary Margin have led to important innovations and to a strengthening of the policy framework for each subsequent Cabinet term.

As the Study Group prepares to embark on the periodic assessment of the framework, this note discusses some aspects of the budgetary policy design and implementation that merit a fresh look. It provides suggestions for modifying some elements of the framework, and for some additional analysis to assess whether other modifications in the framework would be useful. The note first examines a number of issues related to the setting and use of real expenditure ceilings. It then considers the budgetary aspects of the operations of local governments, the FES fund, and government agencies. This is followed by a discussion of several issues related to the target for structural balances, and the "signal value" for the EMU balance. The note concludes by noting the role of the CPB, and discussing the use of cautious growth projections.

I. EXPENDITURE CEILINGS

(i) Coverage of expenditure ceilings: The Dutch expenditure based framework is commendable for the comprehensive and broad-based nature of the expenditure ceilings.[1] The ceilings are transparent in the sense that they include almost all general government expenditures, which also has the benefit of limiting escape routes for additional spending. The inclusion of cyclical elements, however, such as unemployment benefits and other social benefits, as well as other items such as interest payments over which policy has limited direct bearing do individually raise some issues of expenditure control.

With regard to the cyclical elements, inclusion of unemployment benefits (and other cyclically-related items) can reduce the automatic stabilizers on the expenditure side as temporary room created by a cyclical fall in unemployment can be exchanged for an increase in other (possibly permanent) expenditures. With regard to interest payments, it is generally accepted that changes in this category of spending, which reflect movements in interest rates and debt stocks, should not be on par with changes in other types of spending because the government does not have direct control over these payments

(a) Aggregative analysis suggests that, to some extent, movements in unemployment benefits were counterbalanced in recent years by movements in other elements under the expenditure ceilings over different phases of the cycle. In particular, total public sector wages seem to be procyclical, and an increase in them appears to have offset a decline in unemployment benefits. Some preliminary disaggregated analysis by the mission, however, indicates that real *wage rates* in the public sector may be *acyclical* (perhaps reflecting substantial lags between a rebound in activity and in wage rates) while, as expected, unemployment benefits are highly countercyclical. Additional evidence also suggests that new net hiring in the public sector is made with regard to the available room for expansion under the ceilings. Given the somewhat mixed evidence, the mission would suggest further analysis to determine the cyclical behavior of public sector wage rates before deciding on whether to exclude unemployment benefits from the ceilings.

(b) Removing interest payments from the ceilings would help reduce budgetary volatility and further enhance focus on expenditures that are policy determined. Moreover, as windfalls from declining interest payments should not be used to allocate the available funds for general expenditures, but should instead be allocated for structural elements such as aging, the case for removing interest payments is even stronger. While the issue of timing is important in deciding to implement change—with the margin created by declining interest rates and lower payments already having been utilized, but expectations now calling for an upturn in interest payments in the period ahead—these basic principles support the idea of excluding interest payments from the ceilings.

---

[1] Both directly and indirectly (through grants made available to local governments) the expenditure ceilings cover around 90 percent of general government expenditures.

(ii) Deflators and Real ceilings: Real ceilings are used appropriately to prevent the allocation of resources from being affected by changes in the aggregate price level. However, for implementation of the budget, these ceilings need to be converted into nominal values, and using the projected aggregate domestic expenditure deflator raises some issues.

First, the choice of aggregate deflator can have important allocative and distributional consequences. The current deflator was selected on the advice of the previous Study Group because it was more stable and still transparent. But there are also equally convincing arguments for using the GDP deflator (which was used previously), as well as some weighted average of individual deflators (for instance the seven deflators currently used for different types of government expenditure), or a deflator reflecting only private expenditures. The mission would thus suggest a detailed analysis of the behavior of different aggregate deflators during the forthcoming deliberations of the Study Group.

Second, the current practice allows an increase in individual *sectoral* prices to be compensated to the extent that it affects the aggregate deflator. However, if prices affecting a particular sector increase at a persistently higher pace than the overall deflator, resources allocated to that sector can be squeezed. This may particularly be the case at the level of the three sectors with their own ceiling (health care, social security and general government), with ramifications for sectoral planning and the need for subsequent compensation rounds. Some further analysis of this issue may be warranted.

(iii) Net versus gross ceilings: The ceilings are currently net of certain nontax revenues. Thus an increase in these nontax revenues frees up room under the ceilings for other expenditures. Even though the magnitudes involved are not large, it raises issues of transparency—making it less obvious whether deviations from the original path reflect (gross) expenditures or nontax revenues. This argues for separating expenditures and nontax revenues. Against that, there is the issue of providing incentives for line ministries and agencies to collect resources for some part of their spending by letting them set levies and fees that are based on cost-recovery, and not letting them use budgetary resources for these expenditures. The mission can therefore support the continued use of these types of nontax revenues as a netting item. However, in budget documents, gross expenditures and these nontax revenues should be reported separately. Moreover, there are other types of nontax revenues, such as dividends from the central bank and other state equity holdings, that are not affected by incentives, and have the potential to fluctuate. In these cases, consideration needs to be given to not having these as netting items.

(iv) Tax expenditures: There was a considerable expansion during the 1990s in the size and number of tax expenditures. In recent years, welcome steps have been undertaken to reduce many such expenditures. Issues of appropriate measurement and the time lags involved in their calculation suggest that the tax expenditures should be kept separate from other expenditures. Nonetheless, consideration should be given to formally connecting tax expenditures to the fiscal framework. As discussed in the accompanying ROSC recommendations, this can be done, for instance, by setting explicit ceilings for them, which could serve as a moderating factor for new tax expenditures and increase awareness of existing ones by further highlighting their fiscal costs.

(v) Expenditures under the ceilings and National Income Accounts: Given the importance of the EMU balance, a regular (say on a quarterly basis) reconciliation of the expenditure ceilings with national income accounts (ESA95 terminology) would be desirable. Such a reconciliation would enhance transparency (see also the ROSC recommendations on this point) and facilitate better assessment and scrutiny of expenditure developments, without adversely affecting policy design and implementation.

II. Local Governments, FES Fund, and Independent Agencies

A. Local Governments

The expenditure framework does not apply to the local governments. While their own revenues are small and they mostly rely on revenue allocations from the central government in the form of general and specific grants (which are in the framework), the recent unexpected contribution to EMU-deficit by local governments underscore the importance of having a framework that better encompasses all levels of government. The 2004 circular by the Ministry of Finance regarding the required response from local governments in the case of risk of potential breach of the EMU deficit limit is welcome. But the lags involved in information flows can be substantial, and the quality of information seems still to be inadequate. Against this background, it is not clear whether deficit-reducing action could be taken in time were the need to arise. This raises a number of considerations.

Although local governments are required to balance their budget over the medium run, this is in terms of accrual accounting. Even if in any given year they are in balance in accrual terms, they can be in deficit in EMU terms, as only depreciation of investment spending is included in the accrual balances. Given that local governments also have the ability to borrow from the market, their potential to undertake spending and run up deficits can be of some concern. To restrain their spending in times that the EMU signal value threatens to be breached and to prevent them to use incidental resources for structural expenditures, it would be useful to create incentives for local governments to abide by the resource constraints.

The presently conceived system, as described in the above-mentioned circular, appears to present several issues for municipalities given their investment planning, and information on expenditure over runs may be difficult to coordinate. In this context, provinces could be encouraged to play a more active coordinating role. This enhanced role could be underpinned by some formal agreement between different layers of government, whereby the provision of inadequate information could have consequences in terms of the local municipalities' being charged for rectifying the situation.[2]

Even where such an agreement is feasible, the government has to be cognizant of the potential difficulties that could arise from the lags entailed in the process. To reduce the

[2] As the ROSC indicates, further work is needed to examine the management implications for the municipalities.

consequences of this, it would be useful to increase the safety margin for the general government fiscal balance as discussed below.

B. The FES Fund

This Fund is not part of the expenditure ceilings framework. There have been large inflows from gas revenues in the Fund in the last two years (about ½ percent of GDP), and these are expected to continue. This raises the question as to whether the fund should be integrated into the rest of the budget and be part of the expenditure framework, or be kept separate albeit in some modified form.

There are a number of offsetting considerations here. On the one hand, the flows from gas revenues are volatile, and could lead to increased volatility in the budget. At the same time, it is helpful to have dedicated funding for additional infrastructure investment. On the other hand, there is already some substitution from the budget to the FES fund through the so-called "FES bridge" (which is part of the FES-law) whereby the Ministry of Transport and Waterworks is allowed to utilize FES funding instead of the regular budgetary resources. In addition, there have been tendencies to use the fund for projects whose contribution to enhancing potential output growth may be difficult to measure. A related issue of concern is that two allocative processes are created for selection of investment projects.

On balance, the mission would be in favor of retaining the Fund, but amending its operations in a number of important respects. These are elaborated in the ROSC recommendations for transparency and include the following: four yearly planning of a fixed investment envelope to be used for selecting investments; smoothing out the effects of gas price fluctuations through the build up of a stabilization fund containing financial assets; sectoral allocation at the start of the Cabinet term; and integration of evaluation and selection processes with those of line ministries.

C. Semi-Independent Agencies (ZBOs)

There is sometimes a lack of clarity regarding the mandate and operations of the ZBOs. From a budgetary perspective, the Ministry of Finance appears to have adequate aggregate information flows in general. But residual uncertainty remains, especially given that some ZBOs are allowed to borrow and deposit funds outside the Treasury system. This implies that cash usage could be in excess of budget allocations monitored by the ministry. However some of the largest ZBOs have now been integrated in to the Treasury system, implying for them a low level of risk with regard to expenditure overruns. Nonetheless, the mission would advise to the Study Group that the proposed evaluation of ZBOs with regard to reintegrating them into line ministries focus especially on the financial reporting and treasury management aspects.

III. Structural Balances

In the implementation of the expenditure based framework at the start of the Coalition Agreement, an assessment of the budgetary balance needed for long-term sustainability plays an important role. This assessment, in conjunction with the GDP growth projection, is a key input determining the budgetary scope in the Coalition Agreement. The assessment entails a computation of the required structural budget balance, taking into account projections regarding population aging and the need to reduce the debt burden. Separately, the structural budget balance in the past has been computed during the term of the coalition to abide by EU requirements to have the budget balance close to zero or in surplus over the medium term.[3] There are a number of issues that arise in this context.

(i) The current practice is to aim for a measure of structural balance computed by the CPB, based on sustainability considerations. This is appropriate, but given the significant uncertainties entailed in estimating structural balances it is also appropriate that adequate simulation analyses be undertaken to assess the sensitivity of the findings to the underlying assumptions (including regarding productivity growth and labor participation). In this respect, it is important to explore the implications of changes in non-aging related expenditures, as well as changes reflecting the institutional framework relating to pensions and labor participation, for the required structural position.

(ii) As the recent analysis by the IMF has shown, and the experience of Netherlands has confirmed, the problems associated with the calculation of structural balances are particularly acute around economic turning points. Nevertheless, a variety of measures can be taken to improve the calculation of structural balances: their accuracy can be improved by taking into account changes in the composition of output, and by increasing reliance on estimates of elasticities derived from tax and expenditure laws. Policy assessment based on structural balances can be enhanced by focusing on changes in output and budget balances rather than their levels, and a reference to medium-term estimates of trend output can make these estimates less susceptible to volatility of forecasts for output.[4]

(iii) A particular area where problems arise is in the effect of different types of income in the private sector, particularly from corporations, on tax revenues. The calculations of the structural balance can be affected by lags in the impact of changes in the pace of activity on these revenues. There are a variety of reasons, including rules for carry-forward of losses, labor-hoarding effects delaying the transmission from output to employment, and slow response of wages to growth, that suggest that tax revenues may react with a delay to

[3] The July 2005 changes in the Stability and Growth Pact made room for country specific consideration, rather than requiring a budget balance near zero or in surplus over the medium term.

[4] Although in principle, estimates of trend output should not vary substantially year-to-year, in practice this is not the case often due to sharp revisions in forecasted output. In this context, the use of medium-term estimates that are only revised gradually can be useful.

fluctuations in economic activity. Recent OECD analysis shows that, for most countries, taking these lags into account does not alter the cyclically-adjusted balance significantly. This appears not to be the case, however, for the Netherlands, where these lags seem to have an appreciable impact. Our analysis regarding increased volatility in tax revenues is consistent with this finding, and the mission would suggest further investigation of the impact of this volatility on calculation of structural balances.

(iv) From a policy perspective, to avoid the risk of having to take emergency measures, it would be appropriate to adopt a somewhat more ambitious target for the structural balance. This would help provide greater room for maneuver for the play of automatic stabilizers on the revenue side, and help reduce the likelihood that procyclical policies would need to be implemented to reduce deficits to remain within the EMU level. This is also so given that in a monetary union, other policy instruments are not available to deal with shocks to the economy.

IV. NOMINAL SIGNAL VALUE FOR EMU DEFICIT AND FISCAL POLICY

A number of studies suggest that the conduct of sound fiscal policy over a longer period of time is difficult to attain unless expenditure ceilings are combined with an effective deficit (or debt) target. The experience of the last few years has led to a "signal value" of the nominal fiscal deficit to GDP ratio of 2½ percent before corrective measures are initiated to avoid breaching the 3 percent Maastricht limit. Given the uncertainties and the structural changes in the economy, and the speed with which the budgetary situation can deteriorate, there is merit in providing a somewhat larger margin for maneuver by considering a lower "signal value."

At present when the signal value is breached and budgetary measures are taken, the strategy is to revert to the original framework as soon as circumstances allow. There are two issues regarding this approach: first, it can be procyclical as expenditure cuts or revenue measures are given back as conditions are improving; and second, it does not compensate for progress lost in reaching the target for the structural balance at the end of the Cabinet period. This suggests that once the signal value is breached a reappraisal of the budgetary situation may need to be considered, especially if the breach is substantial.

Fiscal policy under the framework has been designed such that there has been a compression in expenditure in the early part of the coalition's term, and a rebound later. The allocation of expenditure ceilings appears to take into account to some extent the projected evolution of the cycle (with the working assumption that any output gap would be closed at the end of the period). If, a year or two before the end of the coalition's term in office, the output gap is evolving very differently from what was anticipated earlier, it would be worth considering mechanisms that could be used for adjusting policies to avoid measures which could be procyclical but which had been planned at the beginning of the coalition period.

A separate consideration concerns desired tax reforms, that are accommodated by explicitly incorporating their estimated budgetary effects into the multiyear fiscal targets at the beginning of the cabinet period. In this respect, the recent steps to discontinue the use of a part of windfall revenue-gains to finance tax cuts is welcome—especially given the cautious nature of GDP growth projections. The use of windfall gains reduces the budget's automatic stabilizers and can entail structural deteriorations as revenue windfalls often are of a temporary nature. However, procyclicality can emerge from changes in taxes that are planned long beforehand but may be implemented when cyclical conditions turn out to be different from those anticipated. In such a case it would be desirable to have the flexibility to phase tax changes differently than planned, or to take offsetting measures to avoid excessive procyclicality.

V. THE NETHERLANDS BUREAU FOR ECONOMIC POLICY ANYLYSIS (CPB)

The CPB occupies a unique position in fiscal policy making in the Netherlands. Its role with regard to objective projections of GDP growth, required structural balances, and other macroeconomic variables is central to the implementation of the expenditure framework, and complements the CPB's extensive analysis and policy evaluation functions. (Indeed its activities span the full spectrum identified in the IMF's recent analysis of Fiscal Councils). In such a situation, its independence and credibility are essential, and the mission fully supports the continuation of the current institutional set up.

There is a specific issue that concerns the use of a cautious scenario in applying the projections for economic growth, prepared by the CPB at the start of a government's term of office, for estimating future revenues and expenditures. The practice has been to use a "safety margin" whereby the growth projection used in the framework is below the baseline projection, to reflect a degree of "caution." This safety margin has been declining successively, and was ¼ percent per year at the start of the current government's term of office. The mission regards the reduction in the safety margin as appropriate. In principle, it is desirable that the baseline should be the best estimate available, to avoid potentially distorting signals, and adversely affecting credibility.[5] This is despite the emphasis placed earlier on higher volatility in government revenues, and higher economic uncertainties. The appropriate response to greater volatility should instead be to have a lower signal value for the EMU balance, and to aim for a higher structural budget balance. In practice, however, it appears to be the case that there are asymmetric costs of adjustment arising from forecast errors. Windfalls in tax revenues resulting from higher than projected growth may be easier to deal with than cuts in expenditures required because of growth shortfalls.[6] Given these political economy considerations, a further evaluation of the appropriate degree of "caution" in growth projections would be useful.

[5] In this context, the usefulness of alternative projections, by domestic as well as external institutions, as a check, and as a spur to further improving the methodology for forecasting does not need emphasizing.

[6] In this context, it should be noted that there is a trade-off between the signal value and additional adjustment effect: the lower the value the more other additional (pro-cyclical) measures need to be taken.