CPB Netherlands Bureau for Economic Policy Analysis

Macro Economic Outlook 2017

MEV 2017, translation of chapter 1

1 Summary

A slow growth is projected for the global economy and world trade, both this year and the next. In 2017, European economic growth will be negatively affected by the increased uncertainty following the UK's Brexit referendum. Inflation in the eurozone is projected to remain low, because of the large amount of currently unutilised production capacity, but will increase slightly next year due to a small increase in oil price. Problems within the European Banking sector and uncertainty about economic developments in China both pose a downward risk to the global economy. Positive risks to the Dutch economy come from domestic sources. The Dutch economy is projected to continue to grow steadily by 1.7%, despite the negative effect of the Brexit referendum and lower natural gas production levels in 2017. Investment growth is high this year and will level off next year. Public spending is also contributing to this growth, partly as a result of the positive 2017 budgetary impulse. Unemployment will decline to 6.2% this year, and is projected to stabilise in 2017. Next year's 1% increase in purchasing power is lower than that of this year. The positive policy impulse for purchasing power will be smaller next year than this year, and inflation will be higher whereas the contract wages remain constant. Purchasing power will be 1.1% for the working population and social benefit recipients, while for pensioners it will be 0.7%. The government deficit will decrease this year to 1.1% of GDP, and in 2017 to 0.7%. This decrease will largely result from increasing tax revenues.

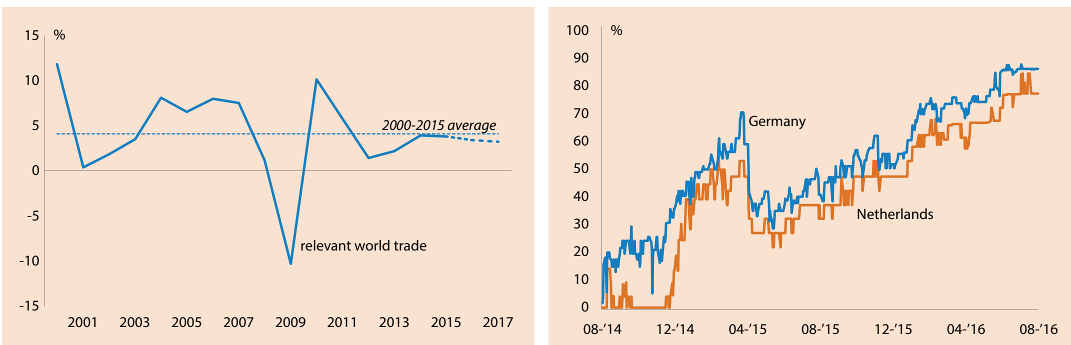
Over the 2018–2021 period, the Dutch economy is projected to grow, on average, by 1.7%, annually, slightly decreasing unemployment to 5.5% in the final year. Although interest rates and inflation will increase slightly, they will remain low. The government budget will be in the black, with a positive EMU balance of 0.9% in 2021, a debt that is decreasing down to 52%, and public finances are sustainable in the long run.

1.1 Summary and introduction

Global economy

The outcome of the Brexit referendum, which surprised financial global markets, implies the materialization of an important downside risk for the European economy. In the short term, the outcome of the referendum temporarily leads to a substantial increase in economic and political uncertainty. This uncertainty will have a negative impact not only on trade, but also on consumption and investments. The UK economy will be hit the hardest; growth is expected to slow down to 1.3% this year and to 0.8% in 2017. And countries with high UK-trade levels, such as Ireland and the Netherlands, will also experience a relatively large effect, as will the southern European countries with an already vulnerable economy (Italy and Portugal) which continue to have problems within their banking sector – European bank shares have gone down considerably, since the referendum. This increased uncertainty is expected to dampen next year's economic growth in the eurozone by 0.2 percentage points (see text box), bringing it to 1.6% this year and 1.5% in 2017.

Figure 1.1 Slight growth in relevant world trade (left); share of government bonds with negative interest rate increases (right)



Source: CPB, Thomson Reuters Datastream, CPB calculations (link).

This negative effect on growth is in addition to the already low growth in the global economy and world trade, while monetary policy is exceptionally expansionary. The low growth level in the emerging economies dampens global growth, in comparison to past levels. A number of countries seem to have reached the lowest point (Brazil), while others (Russia) appear to profit from the slightly increasing oil prices. The Chinese economy continues to be an uncertain factor. The substantially lower growth in the Chinese economy, compared to that of recent years, dampens global growth, although recent indicators on economic activity point to a slightly better performance than previously expected. Productivity growth in most of the advanced economies will remain slow and inflation levels lower than targeted, as a result of overcapacity and strongly increasing resource and energy prices. For the US economy, the outlook generally continues to be positive, with an expected growth of 2.1% for this year, and 2.4% for 2017. Relevant world trade shows a steady growth of just below the multi-annual average (Figure 1.1, on the left). For 2017, growth is projected to be slightly lower, partly as a result of the Brexit referendum.

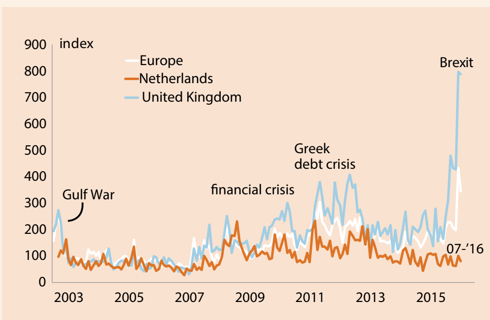
Uncertainty following the Brexit referendum

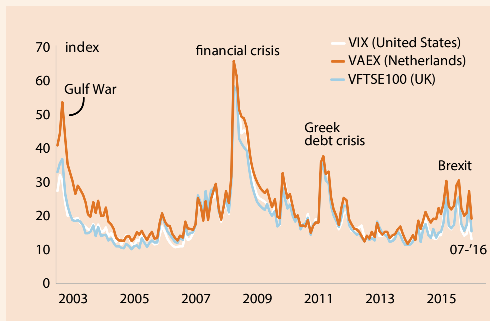
We know the outcome: the majority of Brits have voted to leave the EU. Subsequently, much is still uncertain, such as the actual date of the UK's withdrawal from the EU, the time at which an agreement will be struck about a new regime and about the character of such a regime. Although, in practice, little has changed since the 'leave' vote (the United Kingdom is still part of the EU), the related uncertainty does have consequences for the projections.

Economic data – on which projections are based and that provide direction – as yet, are scarce, this soon after the leave vote. Any projections made by national and international institutes after 23 June have all been based on assumptions. Most have assumed the effects for the short term to include a weakening of the UK economy due to postponed investments and consumption. In combination with a depreciation of the pound, this leads to lower net exports to the United Kingdom. A second short-term effect is a dampening of investment growth in the eurozone, due to the uncertainty about the modalities of the new relationship between the EU and the United Kingdom and about the future of European integration, in general.

A number of economic effects in the United Kingdom could be observed directly following the leave vote. For example, on 24 June, share prices in the United Kingdom dropped by a little over 3%, the exchange rate of the pound decreased by 10% compared to that of the US dollar, and producer and consumer confidence both dropped. In Europe, economic effects were less visible, although the AEX volatility index (VAEX) and particularly the policy uncertainty indicator for Europe did peak (see figure below).

Policy uncertainty and VAEX peak following the *leave vote* on 23 June

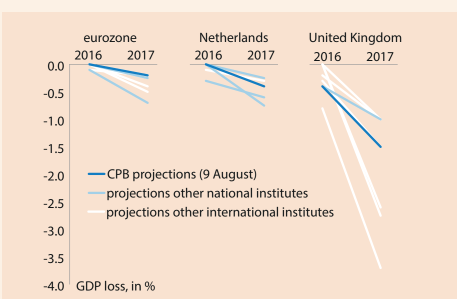




Source: Datastream; "Measuring Economic Policy Uncertainty" by Scott R. Baker, Nicholas Bloom and Steven J. Davis at www.PolicyUncertainty.com.

As a result of lower growth levels in the United Kingdom, depreciation of the pound and increased uncertainty, growth in the Netherlands will be 0.4 percentage points lower in 2017. These projections of the short-term effects of a Brexit are in line with those made by other national and international institutes (see figure below).

Estimated economic effects of the *leave vote*



Source: Rabobank (3 August), ING (12 August), ABN Amro (7 July), Consensus Forecast (August), EC (25 July), ECB/SPF (August), IMF (19 July), Institute of International Finance (August).

A number of advanced economies face negative interest rates against a backdrop of very expansionary monetary policy and low growth prospects. The steady recovery of the economy is coupled with a slight increase in consumption, in combination with saving surpluses. Monetary policy in the eurozone, the United States and Japan remains very expansionary, in order to stimulate the economy. The impact of one central bank's monetary policy on exchange rates is taken into account in the policy-making at other central banks (the exchange rate as an instrument for increasing competitiveness). Policy interest rates and depository interest rates are negative in the eurozone and in a number of other European countries. Since 2014, there has been a sharp increase in the share of Dutch and German government bonds that provide a negative return – currently covering around 85% (Figure 1.1, on the right). Investors are holding on to these bonds despite the negative interest, because they expect the current situation of low growth, inflation and interest rates to continue for some time, and they are looking for safe alternative investments. Banks are obliged to keep a certain share of their equity in government bonds, and institutional investors voluntarily do the same, because of the related risk profile.

Negative nominal interest rates are very rare. There is little experience with their effects. If lower interest rates are passed on by the banks, in theory, this would stimulate businesses and households towards consumption or investment. In practice, wholesale interest rates have dropped and, in a number of cases, so have retail interest rates, which supports demand. As capital will look for higher returns elsewhere, negative interest rates can be assumed to decrease the euro exchange rate, which in turn means imports become more expensive and exports are stimulated. However, there are limits to the effectiveness of negative interest rates. As returns become more negative and the situation continues, storing money under a matrass or in a vault will become more attractive alternatives for small-scale investors. The revenue model of banks will come under pressure and times will become difficult for life insurance companies and pension funds that depend on investments that are safe and deliver returns. Moreover, the flight towards riskier investments with higher returns will grow and may lead to bubbles. Substantial negative interest rates, thus, seem hardly sustainable in the longer term.

Inflation in the eurozone will remain very low this year, because production capacity will not be utilised fully and there hardly will be any catch-up growth. Unemployment in the eurozone will decrease, but will still be far above the multi-annual average. This means there will be little upward pressure on wages and prices. Furthermore, inflation is low as a result of the delayed impact of lower energy and resource prices. The decrease in oil price has meanwhile reversed into a slight increase, due to the limited supply surpluses as a result of production restrictions in non-OPEC countries (e.g. de United States and Canada). For 2017, oil prices are expected to increase, which will have a slightly positive impact on inflation.[1]

Financial markets have calmed down somewhat, after the turbulence around the Brexit referendum. European stock markets, in September, retuned to or even exceeded the level of

[1] This is a technical assumption, based on the average of the oil price futures in Week 28. The technical projections of the exchange rate and interest rate were also based on the realisations in that week.

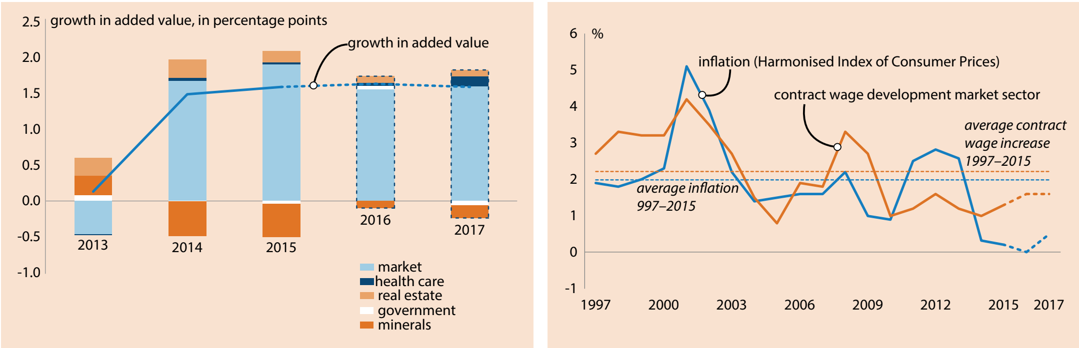
before 23 June, with the exception of European bank shares. The exchange rate of the pound is around 10% below that of the US dollar and euro, while the outcome of the Brexit referendum hardly had an effect on the euro–US dollar exchange rate.

The downward risks to global economic growth dominate. The European banking system continues to have unsolved legacy issues, particularly in Italy. If these problems do indeed manifest themselves, there is renewed risk of problematic government debt levels. In addition, the financial situation of Deutsche Bank poses a risk to the stability of the European financial system. In China, there is a risk of an abrupt correction of the debt-driven growth. A substantially lower growth level of the Chinese economy poses a risk to the global economy. Moreover, a large negative shock would also further deplete the already nearly empty 'toolbox' of monetary policymakers – interest rates can hardly be any lower – and only a small number of countries has the budgetary capacity to absorb such a shock. The unstable political situation in Turkey could jeopardise its refugee agreement with the EU. If this would cause the migration of asylum seekers to increase sharply, it could put pressure on the agreement about the free movement of people within Europe (Schengen), with its ensuing negative economic effects. The positive risks to the Dutch economy are domestic in origin.

The Dutch economy

The Dutch economy will continue to grow steadily, despite the dampening effect of the Brexit referendum and next year's lower natural gas production. The greater uncertainty following the referendum and the lower growth level in the United Kingdom will negatively affect next year's growth in the Netherlands by 0.4 percentage points (see text box) – two thirds of which due to a decrease in the growth in relevant world trade. The other third will result from less growth in domestic spending due to the greater uncertainty. The decision to further lower the ceiling on natural gas extraction from the Groningenveld will dampen next year's growth by 0.2 percentage points (Figure 1.2, on the left). There is still unutilised production capacity and, therefore, there is little pressure on wages and prices (Figure 1.2, on the right).

Figure 1.2 Reduced natural gas extraction dampens growth (left): low growth in wages and prices (right)



Source: CPB calculations, based on CBS data ([link]).

Table 1.1 Main data for the Netherlands, 2012–2017

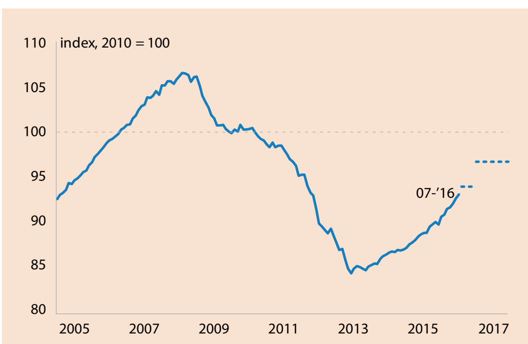
	2012	2013	2014	2015	2016	2017
	mutations per year, in %					
International economy						
Relevant world trade volume of goods and services	1.4	2.2	3.9	3.8	3.4	3.2
Competitor prices (a)	5.3	-3.2	-1.3	6.0	-2.2	1.2
Oil price (in USD per barrel)	111.7	108.7	99.0	52.5	43.7	51.4
Euro exchange rate (USD per euro)	1.28	1.33	1.33	1.11	1.11	1.11
Long-term interest rate the Netherlands (in %)	1.9	2.0	1.5	0.7	0.2	0.1
Volume GDP and spending						
Gross Domestic Product (GDP, economic growth)	-1.1	-0.2	1.4	2.0	1.7	1.7
Household consumption	-1.2	-1.0	0.3	1.8	1.3	1.8
Public consumption	-1.3	-0.1	0.3	0.2	0.8	1.0
Investments (including stocks)	-6.2	-3.9	3.2	6.2	5.0	3.8
Exportation of goods and services	3.8	2.1	4.5	5.0	3.2	3.1
Importation of goods and services	2.7	1.0	4.2	5.8	3.7	3.8
Prices, wages and purchasing power						
Price level Gross Domestic Product	1.4	1.4	0.1	0.1	0.5	0.9
Export prices goods and services, excluding energy	1.4	-0.1	-1.0	0.2	-1.5	0.9
Import price levels	3.2	-1.9	-2.7	-5.1	-3.7	2.1
Inflation, Harmonised Index of Consumer Prices (HICP)	2.8	2.6	0.3	0.2	0.0	0.5
Contract wages market sector (c)	1.6	1.2	1.0	1.3	1.6	1.6
Purchasing power, static, median all households	-1.9	-1.3	1.3	1.1	2.8	1.0
Labour market						
Labour force	1.5	0.8	-0.4	0.4	0.3	0.7
Working population	0.6	-0.8	-0.6	1.0	1.0	0.8
Unemployed labour force (x thousand persons)	516	647	660	614	555	555
Unemployed labour force (in % of labour force)	5.8	7.3	7.4	6.9	6.2	6.2
Market sector (b)						
Production	-1.2	-0.7	2.4	2.8	2.2	2.3
Labour productivity (per hour) (c)	-0.1	0.4	1.6	1.6	0.6	1.4
Employment (in hours) (c)	-1.2	-1.1	0.8	1.2	1.6	0.9
Wage rate (per hour) (c)	2.9	1.7	0.8	0.2	2.3	2.0
Labour income share (in %)	78.4	79.1	78.7	77.1	78.1	78.1
Other						
Individual saving share (in % disposable income) (d)	-0.4	-0.7	-1.4	0.2	2.2	1.7
Balance current accounts (in % of GDP)	10.2	10.2	8.5	8.5	8.7	8.2
	level in % of GDP					
Public sector						
EMU balance	-3.9	-2.4	-2.3	-1.9	-1.1	-0.7
EMU debt (ultimo year)	66.4	67.7	67.9	65.1	63.3	61.8
Collective financial burden	36.0	36.5	37.5	37.7	38.2	38.7

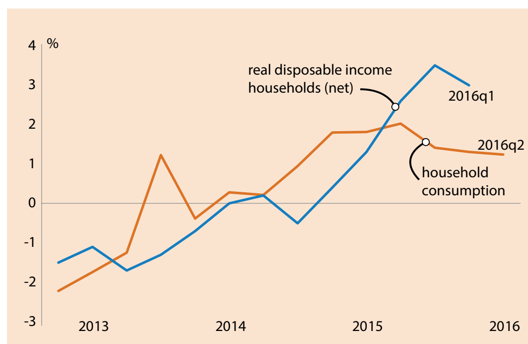
(a) Goods and services, excluding resources and fuels.
(b) Businesses, excluding health care, mineral mining and the real estate sector.
(c) From this year onwards (CEP 2016), CPB will be using employment hours instead of years as the measure for labour input. This affects the figures on wage rates and employment. More information on this subject is provided in a CPB Background Document (in Dutch).
(d) Level; disposable household income, including collective saving. The individual saving share will be 0.6 percentage points lower in 2017, due to the inclusion of the abolishment of personal pension fund management (see the text box).

All spending categories will contribute to growth. Consumption, this year, will increase under a sharp increase in disposable income. Growth in investments is high this year and will level off next year. Government spending will also contribute to growth, partly thanks to the positive impulse provided by next year's budget. The positive contribution of exports will be slightly smaller next year, due to less rapid growth in relevant world trade. Negative risks to growth mostly originate from the uncertain international situation. For the domestic situation in the Netherlands, growth in employment may turn out to be higher and unemployment may be lower than currently projected. Housing market development may also prove to be more positive than foreseen in the projections.

The Dutch housing market is recovering rapidly, with a rapid increase in house prices (Figure 1.3, on the left). The number of houses for sale is decreasing and demand continues to increase, due to demographic developments such as the increase in the number of households. Transaction numbers have returned to pre-crisis level and are expected to continue to increase in both 2016 and 2017. Substantial regional differences in how prices are recovering, however, will remain. In the provinces of Utrecht and North Holland, the number of houses for sale has halved since 2013, while in other provinces this decrease started only recently. New housing production level is still low, compared to pre-crisis levels, which is why the numbers of finished new builds and new houses for sale also remain low. This situation also contributes to the recovery of house prices. The rapid increase in house prices leads to positive equity effects that, in turn, provide an impulse to consumption.

Figure 1.3 House price increases continue (left): only moderate growth in consumption despite sizeable growth in income (right)



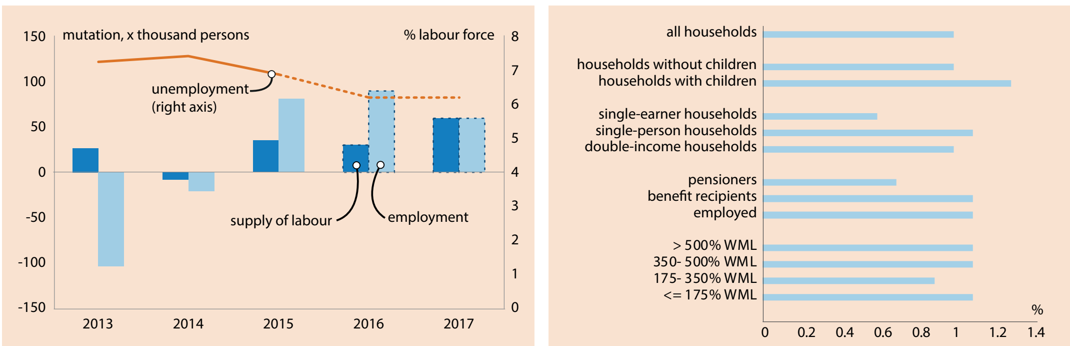


Source: CPB calculations, based on CBS data (link).

Consumption is expected to lag behind disposable income, this year (Figure 1.3, on the right) and saving will increase. This year, in particular, disposable incomes will rise rapidly, among other things due to the 5-billion-euro package of measures to reduce the financial burden, as well as to the increases in employment and real wages. To date, this higher disposable income has only partly been consumed and mostly has been saved. For next year, the increase in disposable income will be smaller, because of the smaller positive policy impulse on purchasing power and a slowdown in employment growth. A larger share of the increase in disposable income is projected to be consumed next year, and consumption will also be supported by the increase in housing equity. Developments in pension fund premiums and payments will dampen the disposable income. The decrease in premiums of this year will be more than compensated by an increase next year, in response to the lower interest rate level. Pension payments in both years, on average, will not be indexed.

The catch-up of investments over the past two years has returned the investment share to the multi-annual average. Uncertainty about the economic prospects will dampen the growth in investments. Capital costs are low, due to the low interest rates, and the demand for credit is increasing, from large companies as well as SMEs. At the same time, business credit provision by banks still continues to decline, and currently is 3% lower than last year. On balance, investment growth is projected to level off, next year, to 3.8%.

Figure 1.4 Employment, labour supply and unemployment (left): purchasing power will increase next year, for all groups (right)



Source: CPB calculations, based on CBS data (link).

Employment increased rapidly, during the first half of this year, and has led to a decrease in unemployment. Over the projected period, the increase in employment will slow down, slightly, under a slightly increasing labour productivity and a constant production growth in the market sector. For this year, the increase in employment (taking place solely in the market sector) will be more than enough to absorb the labour supply. This will decrease unemployment from 6.9% to 6.2%. The increase in employment in the market sector and in health care, in 2017, will just be sufficient to absorb the increase in labour supply, which will stabilise next year's unemployment level (Figure 1.4, on the left). The uncertainty about the decrease in unemployment is the result of the uncertainty about the economic recovery, the pace at which the previously withdrawn labour supply will return to the labour market, and about the increase in labour productivity. Should employment and GDP increase more rapidly, this will also cause unemployment to decrease further than is currently foreseen in these projections.

The real wage rate in the market sector, both this year and the next, is expected to increase by more than labour productivity, under relatively high company profits. Contract wages in the market sector, which saw a modest development over the past year (Figure 1.2, on the right), are expected to rise this year and the next, by 1.6%. Contract wage developments in health care and the government sector will follow suit. Over the 2011–2014 period, wage increases within the government sector were limited due to cuts in the wage budget.

However, these were nearly fully compensated by a simultaneous growth in incidental wages. From that perspective, there is little reason to expect a deviation in the increase in contract wages within the government sector for this year and 2017, apart from the delayed effect of this year's wage agreement. For both years, inflation is projected to remain very low, in line with the low inflation in the rest of the eurozone. Inflation next year is expected to increase slightly, due to higher energy and import prices, to 0.5%.

The purchasing power will be positive in both years, for all population groups. In both 2016 and 2017, contract wage increases will be substantially higher than inflation, and this provides a positive impulse to median household purchasing power. This year, the 5-billion-euro package of measures also contributes to the increase in purchasing power, and the increase in median purchasing power will come to 2.8%. Next year, it will be clearly lower, because then the positive policy impulse to purchasing power will be smaller, and because inflation will be higher under an equal contract wage increase. The Cabinet's purchasing power package of measures will have a positive impact in the coming year. Its main measures include higher general tax deductions, pensioner deductions, health care insurance subsidy, and child-related budget. In addition, the proposed cuts in rent subsidies will be abolished and rent subsidies will be increased further. This will be financed, in part, from a smaller increase in labour deductions. Thus, the increase in median purchasing power next year will come to 1.0%. Purchasing power increase for the working population and for benefit recipients will come to 1.1% and for pensioners to 0.7%. Benefit recipients will profit mostly from increases in subsidies on health care insurance and rents; pensioners will also benefit from these increases, in addition to the increase in pensioner deductions.

Public finances

The government deficit is projected to decrease to 1.1% of GDP in 2016 and 0.7% in 2017. These decreases will mainly be due to increases in tax revenue. This year, there is a sizeable windfall in company tax that will continue into next year. An explanation for this windfall could be that most of the losses that were incurred as a result of the crisis have since been compensated for. In addition, under the current interest rate levels and payment regulations, companies benefit from paying their taxes as early as possible. Tax revenues next year will also increase substantially, because of the temporary additional revenues from the phasing out of the personal pension fund management schemes for director–large shareholders (see text box). In contrast, increases in expenditure will be lower than in nominal GDP, largely as a result of measures in the Government Agreement. Moreover, interest payments will go down due to low interest rates. Dutch EU contributions will also be lower this year, because deductions for the Netherlands are implemented retroactively, as a result of the ratification of the Own Resources Decision. Deficit reduction will be dampened next year by the upward impact of the package of measures for 2017 as decided on by Cabinet (see text box). In addition, lower natural gas revenues, caused both by lower gas prices and by the lower gas extraction ceiling, will also dampen deficit reduction, this year. Next year, the higher natural gas price will counterbalance the impact of the lower production level. The government deficit projected for 2016 and 2017 will be lower than foreseen in the Government Agreement. Improvement in the structural balance, corrected for the economic situation and incidents, will be 0.1% of GDP in 2017. EU budgetary regulation requires an improvement of

0.4% of GDP. Corrected public spending will increase by 0.7%, next year. On the basis of EU budgetary regulation, public spending should be reduced by 0.3%.

The government debt continues to decrease rapidly, to 61.8% in 2017. The decrease is the result of increasing GDP (denominator effect), treasury banking by sub-national government authorities, and financial transactions such as the privatisation of ABN AMRO and ASR, and the sale of SNS Propertize.

Personal Pension Fund Management and the 2017 budget

From 1 January 2017 onwards, pension savings can no longer be accrued and facilitated through Personal Pension Fund Management (*Pensioen in Eigen Beheer* (PEB)). The PEB measure concerns the abolishment of the regulation under which director-large shareholders ('DGAs' in Dutch) could build up their own pension savings in their private limited liability company ('BV' in Dutch) (a). DGAs can cash in their existing amount in pension savings via tax deductions in 2017, 2018 and 2019. The deduction level is the highest for 2017 (34.5%) and decreases to 19.5% in 2019. DGAs may also opt to leave the pension savings where they are, or to commute them to another savings scheme. They cannot, however, make new deposits to add to the pension fund. In all cases, pension payments will not commence until the retirement date.

Over one third of DGAs is expected to opt for cashing in their pension fund. A certain number of PEB facilities have a solvency ratio of less than 100% and, thus, are underwater, which means cashing in is not an option. In addition, some DGAs will not be able to cash in their pension savings because their partner or former partner refuses to sign off on cashing in the savings amount. The majority of the remaining number of DGAs are expected to opt for cashing in. Their pension capital, via a sizeable tax deduction, will thus become freely available to them. The advantage of cashing in will be the greatest in the first year, as deduction levels decrease in the two subsequent years.

By bringing tax revenues forward, as a result of the abolishment of pension-related tax benefits (*Witteveenkader*) and the option of cashing in the PEB, this measure will have a projected positive impact on the EMU balance of 2.1 billion euros in 2017, 1 billion in 2018 and 0.9 billion in 2019 (b). The projected budgetary effects are rather uncertain, largely because of the assumptions on behavioural effects.

The measure leads to higher tax payments and a lower disposable income, but will not affect consumption. This will result in a 0.6 percentage point lower savings share in 2017. Consumer spending is assumed to neither decrease nor increase, because of the amount in pension savings that will become available for consumption. The projections, therefore, included the measure as being a shift between various forms of capital, after incorporation of the latent tax debt.

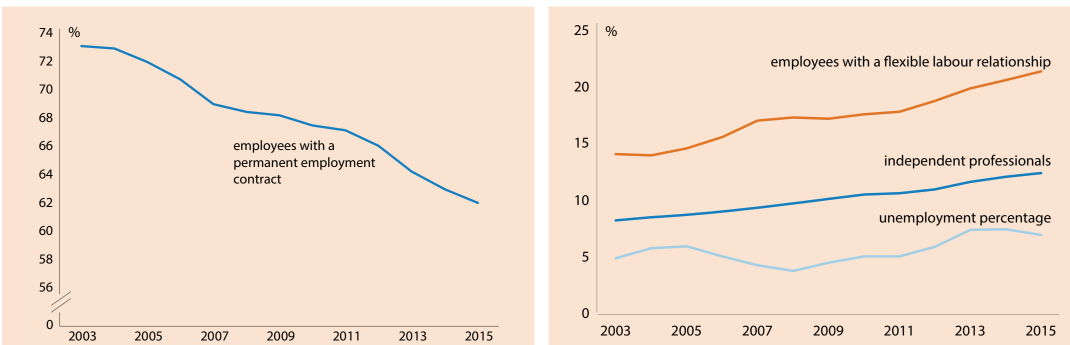
The PEB measure will lead to incidental additional income, and so will the windfall in corporation tax in later years. In addition, spending will be increased structurally, and there will be reductions in financial burden. This, on the one hand, will lead to a more positive purchasing power for the elderly and for benefit recipients, but also to lower structural employment, on the other. Furthermore, funds have been made available for societal priorities and for the draft decision to lower the ceiling for natural gas extraction from the Groningenveld to 24 billion m^3.

(a) Parliamentary letter about Personal Pension Fund Management, 1 July 2016 (link).
(b) The net constant value of the measure is 62 million euros. The positive effect, among other things, will result from the abolishment of the pension-related tax benefit measure for the pension funds that are currently underwater. Those BVs make use of the tax deductions, but would never be able to issue taxable pension payments.

1.2 Analysis

Permanent employment contracts are no longer the norm – not in a legal sense, but in practice, as statistics indicate. The Dutch labour market is becoming increasingly more flexible. The number of permanent employment contracts is decreasing, while the number of flexible contracts and the hiring of independent professionals is rising (Figure 1.5). Flexible contracts have increased strongly, particularly among young and lower educated people.[2] Is this a structural change and does it require a policy response? Change is not always a bad thing and some changes are only temporary. Many of the explanations that could lead to a resigned attitude, however, do not bear scrutiny. Below, a number of those explanations are discussed.

Figure 1.5 Increased flexibility (left) not caused by the economic situation (right)



Source: CBS (link).

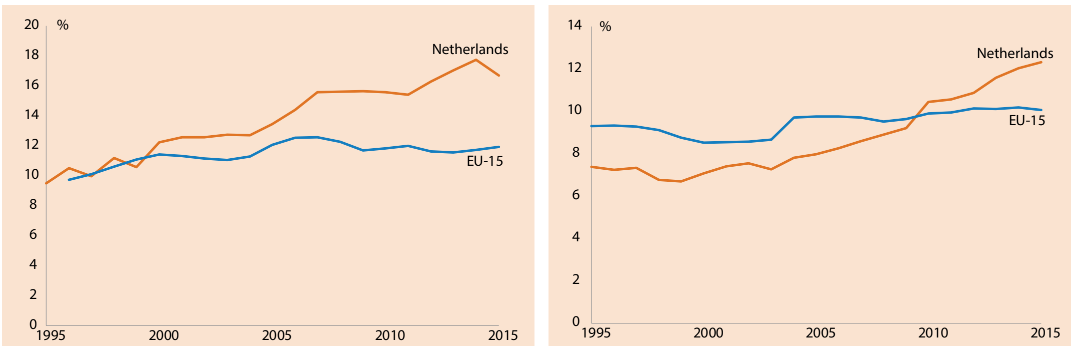
Increasing flexibility may be a good thing if it is the result of the preference of both employers and clients as well as employees and independent workers. The picture that emerges from surveys on the subject, differs per contract type.[3] Of the respondents with a temporary individual contract, temp agency contract or payroll contract, 80% to 90% considered having a permanent contract to be important or very important. For independent professionals, this percentage was much lower; 73% of them indicated to prefer work as an independent entrepreneur. This does not alter the fact of there being substantial dynamics among independent professionals; over a quarter of them also has a contract in paid employment or returns to paid employment after a while. This may be due to changing preferences, but might also be the result of them being insufficiently successful as an independent professional. Of all such professionals that start their independent careers, over 60% is still doing so after the first four years.[4]

---

[2] For example, see the text box on page 46 of the *Macro Economische Verkenning 2016 (in Dutch)*.
[3] Ecorys, Contract types and motives of both employers and employees, 2013, Table 3.5 and 3.6. The stated information is based on existing arrangements in the fields of, for example, taxation and social security.
[4] IBO Zelfstandigen zonder personeel [independent professionals], Ministry of Finance, 2015 and N. Bosch (2014), Succes als startende zelfstandige [The success of starting independent professionals (in Dutch)], CPB Background Document (link).

Another explanation could be that of changing economic circumstances that cause the demand for flexible labour to increase strongly. Technological developments, globalisation and increased competitiveness require employers and clients to be more flexible. Such trends are global in character. An international comparison shows, however, that the development of the Dutch labour market clearly deviates from developments in the surrounding countries (Figure 1.6). It seems unlikely that the Netherlands is affected by global trends in a totally different way than any of the other countries in Europe.[5]

Figure 1.6 Share of temporary employees (left) and independent professionals (right), international comparison



Source: Eurostat. (link)

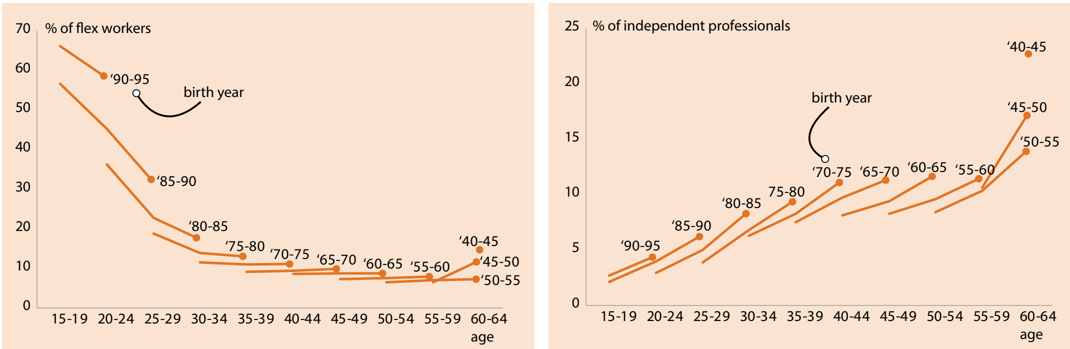
A third explanation is that of flexibility being a temporary phenomenon that is connected to the prevailing economic situation. In economically unfavourable times, people would not be hired in permanent employment, and when the economy begins to improve, employers would start by cautiously hiring staff on flexible contracts. This explanation also does not hold up. Irrespective of whether unemployment increases or decreases, the share of flex workers and independent professionals is continually growing; at most, the economic situation has an effect on the pace of this growth, and for independent professionals there appears to be no effect at all (Figure 1.5, on the right). Conversely, a large share of flex workers and independent professionals may in fact help to absorb shocks without causing a strong increase in unemployment. A possible explanation for the fact that unemployment in the Netherlands, from an international perspective, increased only marginally between 2009 and 2013, is that these types of workers began to work fewer hours, instead of becoming unemployed.[6]

The ongoing reduction in permanent contracts is also reflected by the experiences of consecutive cohorts (Figure 1.7). Young people more and more often start work on a flexible contract, but over time they outgrow this situation – as was the theory. Figures, however, show that although the chances of obtaining a permanent contract increase with age, they

[5] Eurostat uses a slightly different definition of flex work, compared to that used by Statistics Netherlands (CBS). The choice of using the EU-15 originates from the objective of selecting comparable countries with available data series over as many years as possible.
[6] For example, see the text box on page 46 of the CEP 2014 (in Dutch).

become smaller for each consecutive cohort. A similar situation applies to independent professionals. The transition towards becoming an independent professional increases in the second half of people's professional careers. For them, the chances of becoming independent increase for each consecutive cohort.

Figure 1.7 Young cohorts are employed more often as flex workers (left) and independent professionals (right)



Source: CPB calculations based on CBS data (link).

If the increasing flexibility cannot be explained, largely, by the preferences of the members of the workforce, if there is no unavoidable international trend, and if developments cannot be considered only temporary, then a plausible explanation seems to be that of how the Netherlands has organised its employment. After all, choices are not made within an institutional vacuum. Institutions canalise the behaviour of labour market participants. Regulation is aimed at greater predictability and lower transaction costs, protection against misuse of market power and against short-sighted behaviour as well as at achieving risk solidarity. Its implementation varies between countries. The Netherlands, for example, has a relatively high level of protection with respect to permanent contracts and a relatively large difference between how permanent and flexible contracts are protected. Coverage in case of illness, disability or permanent disability and of the second tier pension is relatively broad, but hardly provides cover for independent professionals.[7] This places more pressure on the system. Regulation has the potential of benefiting all participants in the labour market, but is particularly effective when a balance is struck between the rights and responsibilities of the wide variety of participants, and when they cannot, will not and should not withdraw from those rights and responsibilities. The systematic and rapid increase in people with flexible contracts and independent professionals in the Netherlands suggests the effectiveness of regulation is changing.

As stated above, the prevalence of permanent cont is decreasing. A growing number of workers cannot achieve their preference of having a permanent employment contract. Moreover, the chances of achieving this are relatively small for people with a rather weak labour market position. Facilities for those on a flexible employment contract are meagre.

---

[7] For example, see *Kansrijk Arbeidsmarktbeleid (Promising Labour Market Policy),* Chapters 3 and 4 of the Dutch version of the main report.

Payroll contracts usually offer less protection; regulation regarding unemployment and pension fund systems with their build up regimes and entitlements are not constructed to suit people who have variable and uncertain employment contracts. Independent professionals are happier about their situation, but the legitimacy for their current fiscal facilities is only fragile. With respect to this group, there is a relatively large level of confidence in their ability to be self-supporting, and there are only limited possibilities for risk sharing and solidarity. Redesigning the regulation, starting from the base, would probably provide a different result. The nature of such redesign can be widely debated, as has become clear over the last years. Experience has shown that, in the Netherlands, action on any subject is most likely to be taken if that subject is included in the Government Agreement and when a sufficient number of preliminary studies have been conducted. [8] This is a promising coincidence, as over the last period, an impressive stack of reports have been publicised on this subject and the parliamentary elections are drawing near.[9] Actions speak louder than words, as the saying goes.

[8] Lejour, A.M. (2016), The political economy of tax reforms, CPB Policy Brief 2016/08 (link).
[9] Studiegroep Duurzame groei, Kiezen voor duurzame groei [Study group sustainable growth, Chosing sustainable growth], July 2016 and IBO Zelfstandigen zonder personeel (independent professionals], Dutch Ministry of Finance, 2015.

Publisher:

CPB Netherlands Bureau for Economic Policy Analysis
P.O. Box 80510 | 2508 GM The Hague
+31 (070) 3383 380 | info@cpb.nl

September 2016 | ISBN 978-90-1239-863-3