CPB Netherlands Bureau for
Economic Policy Analysis

Macro Economic Outlook 2021

Analysis
Corona hits weak spot
→ page 14

The economy will grow again this year, from the third quarter onwards, but the corona impact reverberates. Many painful adjustments are yet to come.

In the baseline projections, the economy will shrink in 2020 by 5%, followed by over 3% growth in 2021. Unemployment will increase to 6% in 2021. **Under the second-wave scenario, the economy will shrink also in 2021** and unemployment will increase towards 10%.

Public finances severely affected by financial support measures and lower tax revenues, **but are not in jeopardy** — in neither the baseline projections nor the scenario. Measures to limit the deficit are not called for.

Corona-related uncertainties

duration of restrictions

arrival of vaccin

developments abroad

Other risks

geopolitical tensions

Brexit trade agreement

CPB Projections

September 2020

CPB data Prinsjesdag 2020

After the historical decline in trade and production, Dutch economic growth will pick up again from the third quarter onwards, but the economic blow continues to reverberate

To do justice to the large degree of uncertainty, CPB presents another scenario in addition to the basic projections

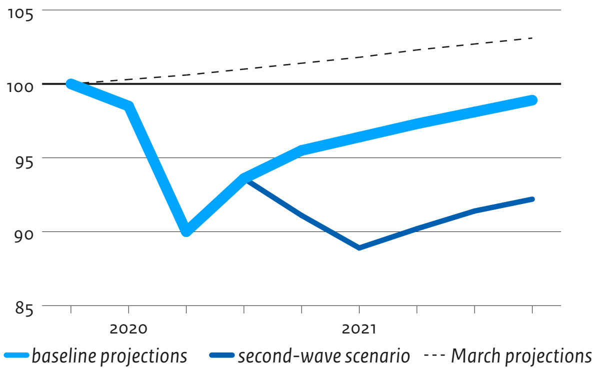
Economic development

Baseline projections: economy is growing again, but remains below 2019 level

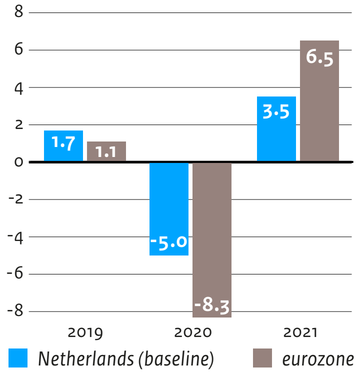
Scenario: GDP decreases further due to new major lockdowns

Economic downturn in the Netherlands less severe than elsewhere in the eurozone

GDP change per quarter, compared to Q4 2019 (2019 = 100)



GDP changes, per year, in %



Corona-related uncertainties

duration of restrictions

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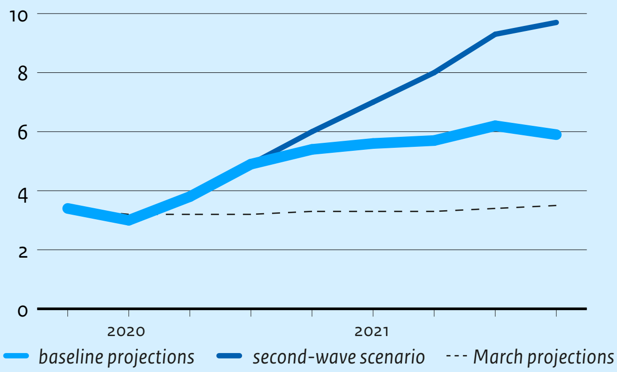
Labour market

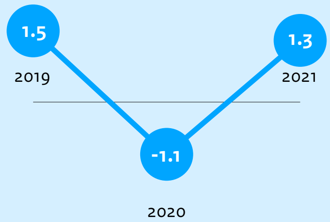
Labour market developments very turbulent, due to social distancing measures, largest increase in unemployment yet to come

unemployment per quarter, in % of the labour force



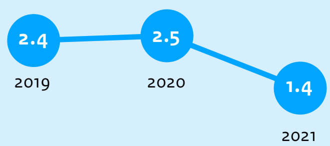
Discouraged by the crisis, fewer people are actively in search of employment

change in labour supply, in %



Wage increases in the market sector decline due to higher unemployment and uncertain prospects

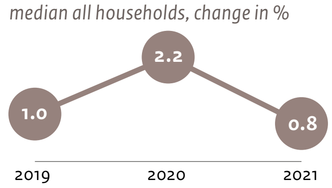
change in CAO wages businesses, in %



Individual purchasing power may turn out very differently; for example, in case of loss of income. This type of personal impact is not included in static purchasing power

Static purchasing power

median all households, change in %



Static purchasing power will increase this year because of already agreed wage increases and a decrease in financial burden. In 2021, wage increases will be smaller.

Analysis: Corona hits weak spot

Young people, the self-employed, flex workers and vulnerable groups are carrying a disproportionally large share of the economic blow. The challenge is to address underlying inequality, so that society will be more resilient if and when the next crisis hits

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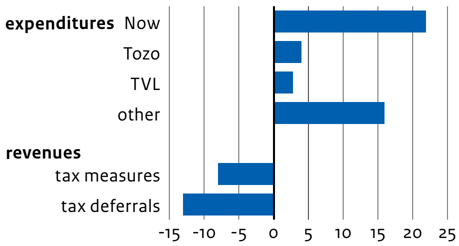
Public finances

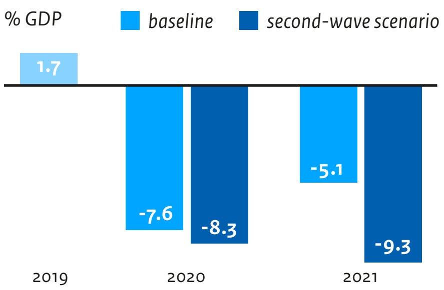
Public finances severely affected by financial support measures and lower tax revenues, but are not in jeopardy

Support packages

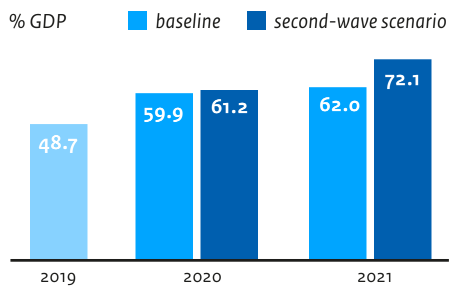
billion euros



EMU balance



Government debt



Update medium-term outlook (MLT) — 2022–2025

This update includes the coronavirus consequences, over the 2022–2025 period. It aims to provide food for thought for policy in the coming Cabinet term

1.6%

GDP growth *between 2022 and 2025, on average, will be 1.6% per year, in case there is no second lockdown*

4.5%

Unemployment *is projected to peak in 2021, after which it will decline to 4.5% by 2025*

-1.7%

The **budget deficit** *will decrease to 1.7% of GDP and government debt will increase to 66.8% by 2025*

The MLT is a separate publication, published on www.cpb.nl

Despite the GDP growth projected for the 2022–2025 period, part of the corona-related missed growth cannot be recovered

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Main points

After a historical decline in trade and production, the Dutch economy is projected to grow again from the third quarter onwards, but the blow will reverberate. Economic activity has partly rebounded, following the lifting of a large number of physical contact restrictions. As a result, the Netherlands is doing slightly better than many other countries. The damage is nevertheless substantial and has largely yet to manifest itself. Unemployment and bankruptcies are slowly responding to GDP development. The government's support policy has bought time for companies to make a number of painful decisions, but will not be able to prevent all of them.

Some of the damage is likely to be permanent. For now, the remaining social distancing measures and uncertainty about the future will slow down the recovery of economic activity. As the crisis lasts longer, hopes of a full recovery are fading away. Bankruptcies and unemployment are damaging intangible assets and human capital. Not all of the missed investment opportunities will be recovered, migrant workers will stay away, and productivity will suffer as a result of reduced economic dynamics.

The epidemiological situation remains precarious, making the uncertainty about the economic outlook enormous. The extent to which countries are able to combat the virus and whether new or prolonged physical contact restrictions prove necessary in the coming period will determine the pace of economic recovery. In Europe and China, the prevalence of the coronavirus has been considerably reduced, but in some countries, a tightening of certain social distancing measures has already proved necessary. Elsewhere in the world, the situation is gloomier: in the United States and in a number of large emerging economies, the initial wave has not yet been brought under control.

In order to do justice to the uncertainty, and in addition to the baseline projections, CPB also presents a scenario in which large-scale physical contact restrictions yet again need to be implemented. In the baseline projections, the economy will shrink by 5% in 2020, followed by more than 3% growth in 2021. Unemployment is projected to increase to 6% in 2021. Under the second-wave scenario, the economy will also shrink in 2021 and unemployment will increase to 10%.

When interpreting GDP figures, it must be emphasised — even more so than usual — that GDP is not a measure of prosperity. Not everything of value can be measured. Things like neighbourly support, family visits and home schooling cannot all be captured in economic growth figures. The corona crisis has major consequences for the things that affect quality of life, such as celebrating a wedding or jubilee, and going to festivals, theatres and concerts. And there are great concerns about loneliness in nursing homes and about children in vulnerable home environments.

The corona crisis may increase inequality. In the analysis that accompanies the MEV, CPB calls attention to the unequal economic effects of the corona crisis. Young people, the self-employed, flex workers and vulnerable groups on the labour market carry a disproportionately large share of the economic effects of the crisis. This causes already existing cracks in the labour market to be deepened. Corona can also increase existing unequal opportunities in education and thus exacerbate income inequality, in the long term. In the short term, the government can support the groups that are most affected. However, the real challenge lies in tackling the underlying vulnerabilities themselves to ensure that society is more resilient by the time the next crisis hits.

The apparently favourable static purchasing power figures should be seen in conjunction with the sharp increases in unemployment and government debt. In 2020, static purchasing power will increase as a result of already agreed wage increases, moderate inflation and an average reduction of 2.2% in the financial burden. In 2021, wage development will be much more moderate, but the announced reduction in financial burden will still lead to an increase in purchasing power of 0.8%, on average. When interpreting these figures, however, it should be noted that, for a large number of people, job losses and turnover losses of the self-employed are causing substantial reductions in income which are not visible in the static purchasing power figures, nor do they show that the government has taken over part of the wage costs.

Public finances have been severely impacted by support measures and lower tax revenues, but they are not in jeopardy. Support measures, according to the baseline projections, lead to an unprecedented budget deficit of almost 8% in 2020. In 2021, the deficit will recover to 5%. Under the second-wave scenario, the government debt will increase to 72% by the end of 2021, which is still below the levels considered risky in the literature. As a result, and given the economic situation, no obvious deficit-reducing measures are foreseen.

Extending the support policy until the summer of 2021 will reduce the increase in unemployment, and additional spending will support the economy. The support policy has been extended until July 2021, with a gradual phasing out of certain measures making the package more focused on adjustments and retraining. Due to the continuation of the support and a spending impulse resulting from additional expenditures, unemployment will increase less rapidly than in the August projections, although the government deficit continues to increase.

1 Summary and analysis

1.1 The economy in 2020 and 2021

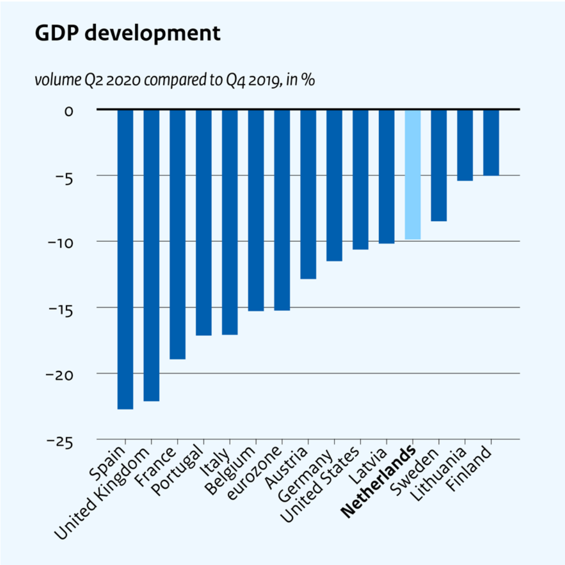
Economic prospects continue to be dominated by the corona crisis; to do justice to this uncertainty, CPB uses two scenarios. The pandemic and the measures taken to contain the spread of the virus have caused an economic shock that is greater than that of the previous crisis. The course of the pandemic determines economic development, which means that the level of uncertainty surrounding economic projections is unusually high at the moment. For the Netherlands and its major trading partners, the baseline projections assume no new large-scale physical contact restrictions are needed and that the pandemic will be brought under control over the course of next year. But new lockdowns, both in the Netherlands and elsewhere, are also conceivable — as is assumed under the second-wave scenario. These two scenarios should not be understood to provide a range, as they serve to illustrate the possible consequences of the course of the pandemic. Apart from corona, there are also other considerable uncertainties surrounding the projections. Additional risks, for example, include developments with regard to the Brexit and the US presidential elections, as well as the impact of the European financial support packages.

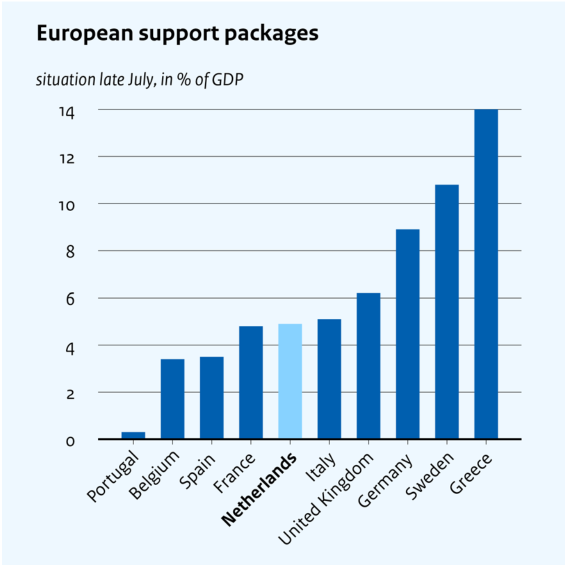
The corona crisis started as a supply shock and has gradually developed into a demand crisis. In order to contain the virus, entire sectors of the economy (hospitality, physical contact professions, large events) were shut down. The social distancing measures have also caused scarcity in places where production chains were disrupted. Uncertainty and the call for people to stay in their homes, as much as possible, have also led to a sharp drop in demand for non-essential goods and services (e.g. clothing and transport). In contrast, the special nature of this crisis has meanwhile also caused the economy to run at full speed in other sectors (e.g. supermarkets and online retail). Income losses and diminished consumer and market confidence due to the uncertain future have subsequently made households reluctant to consume and caused businesses to postpone investments. This demand crisis is continuing, even after most physical contact restrictions have been lifted, thus increasingly dominating the issues on the supply side.

The economy is unlikely to return to its former level, as part of the damage will prove to be permanent. For now, the remaining social distancing measures and the uncertainty about the future will put a brake on the recovery of economic activity. As the crisis persists, hopes of a full recovery are fading away. Bankruptcies and long-term unemployment may damage tangible and intangible assets and human capital. Not all of the missed investment opportunities can be recovered, migrant workers will stay away and productivity will suffer as a result of reduced economic dynamics. Unemployment will eventually return to its structural equilibrium. This is examined in more detail in the medium-term outlook (MLT), which is published by CPB together with this MEV.

Although the shock is global, development of the pandemic and policy response, together, will determine both the level of economic decline and the pace of recovery. The economic shock follows the development of the pandemic; where China was impacted mainly in the first quarter, Europe experienced the greatest impact in the second quarter. The United States was also most severely impacted in the second quarter, although its recovery path is uncertain, as the initial wave of infections is not yet under control. In a number of emerging economies (e.g. South America, India), the pandemic did not strike until this summer. Although there are country-specific factors, it can roughly be said that countries with the strictest lockdown measures suffered the most severe economic consequences. Within Europe, this can clearly be seen in the differences in the depth of the downturn between southern and northern European countries. The extent to which countries have automatic stabilisers or can afford generous financial support policies, partly determines the severity of the downturn and probably also the pace of recovery. The European financial support packages are aimed to reduce these differences. This money has yet to reach the economy, but announcement and confidence effects are also to be expected.

Figure 1.1 Size of the impact and the support varies greatly





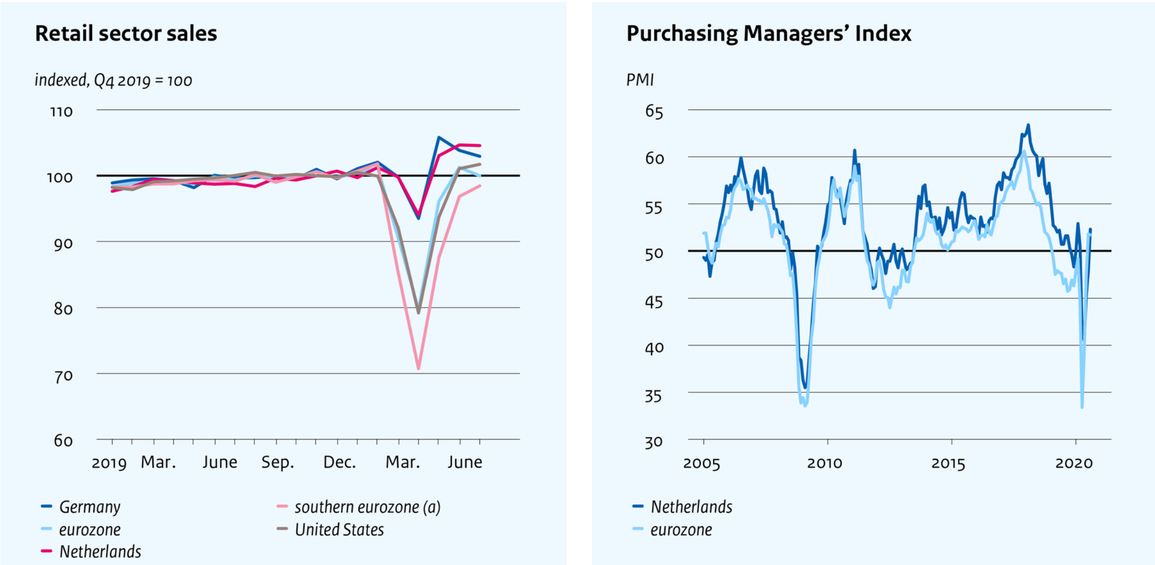
Source: CBS, Eurostat, U.S. Bureau of Economic Analysis and CPB (link).

World trade is slowly recovering after a historical decline, while the world trade that is relevant to the Netherlands has developed slightly more favourably. Contrary to the previous crisis, the initial shock is now primarily affecting domestic demand, rather than external demand. Nevertheless, at 12%, current world trade has decreased a little more than in 2009. After the easing in April and May, trade levels initially rebounded somewhat, but since then have slightly slowed down again. World trade relevant to the Netherlands decrease slightly less, because Europe was affected relatively early and the response was rapid. Another factor is that northern Europe (with the exception of the United Kingdom) has been affected much less severely than southern Europe.

In the Netherlands, the decrease in GDP, although of historical proportions, has been relatively limited. This decrease of around 10% in the first and second quarters of this year can justifiably be called historical. For the Netherlands, it is by far the largest decrease since the Second World War, clearly greater than that of the previous crisis. Nevertheless, in most other countries, the blow is even greater. It is too early for a definitive analysis of what causes this difference, but explanatory factors are likely to include the not too strict lockdown, the Dutch sectoral structure (i.e. not heavily dependent on tourism or consumer durables such as cars), the size and rapid implementation of the policy support package, and the relatively advanced nation-wide digitisation that has facilitated working from home and online retail.

The Dutch economy is growing again after the low point during the lockdown, but recovery is far from complete. Most indicators of economic activity are showing the lowest point to have been in April/May. Economic activity picked up again once most of the physical contact restrictions were lifted. There may be some catch-up or substitution effects with, for example, retail sales having more than recovered. However, the recovery is by no means complete, as the consumption of services, for example, is still far below pre-corona levels.

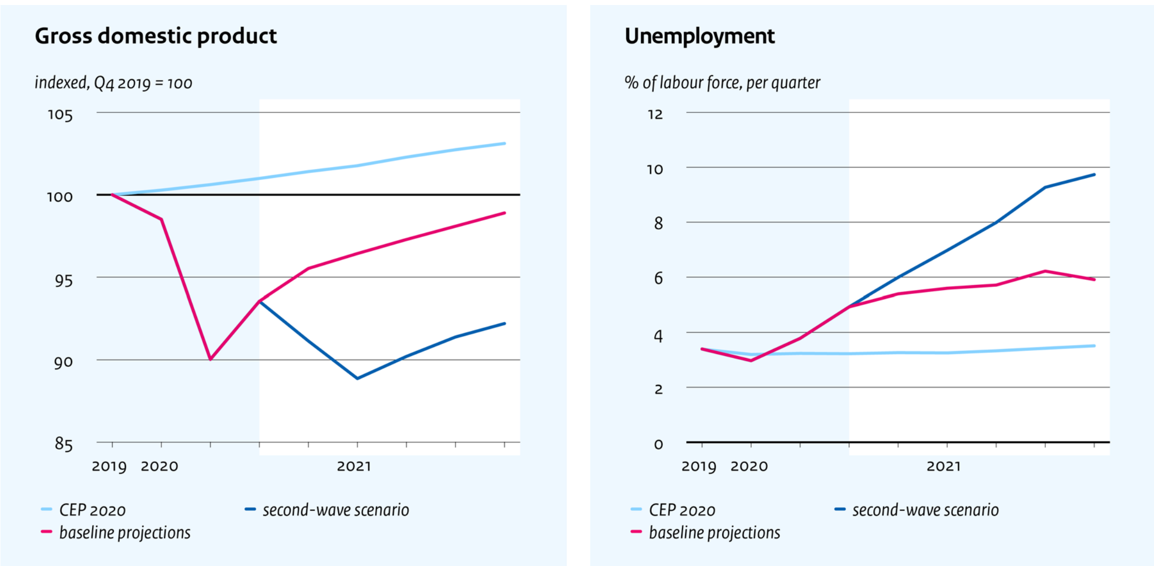
Figure 1.2 Indicators of economic activity point to recovery from May/June onwards



(a) Unweighted average for France, Italy, Spain and Portugal.
Source: Eurostat, U.S. Census Bureau and IHS Markit (link).

In the baseline projections, recovery will gradually continue, whereas in case of a second wave, the economy will shrink also in the next year. Recovery from June onwards translates into solid GDP growth for the rest of the year and in 2021. But the level of recovery is far from complete; on balance, the downturn in 2020 will be 5%, followed by a recovering growth of over 3% in 2021. As a result, at the end of the projections' horizon, GDP is still below its 2019 level, and more than 4% below CPB's projections of before the corona crisis. Under a second-wave scenario, recovery will be nipped in the bud. In that case, additional problems would become more likely, because of the delayed impact of the crisis via the housing market and the international financial system. As a result, under this scenario, there will be a decrease in GDP of 3%, next year.

Figure 1.3 Unemployment continues to reverberate after economic growth sets in

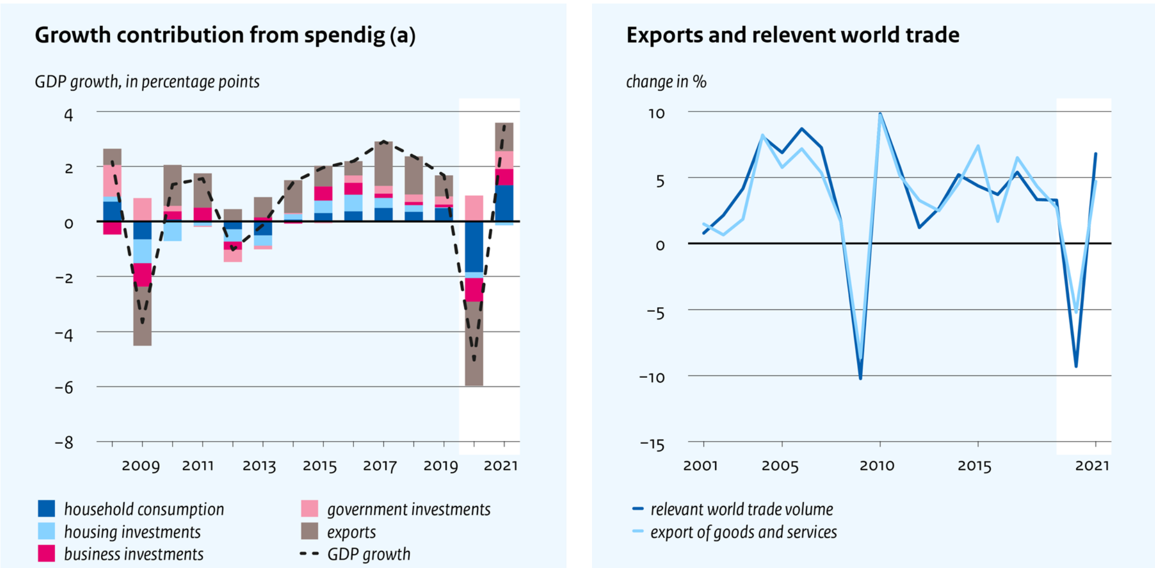


Source: CBS and CPB (link).

However, the downturn reverberates in the baseline projections, as well. Most of the painful adjustments have yet to come. Although GDP is growing again, most of the negative impact is yet to be felt. The government's economic support measures have prevented companies from running into major financial problems during the initial supply shock and this meant no immediate lay-offs were necessary. This has prevented a domino effect and bought businesses some time until the initial supply shock would largely be over. But the support policy cannot prevent bankruptcies and lay-offs when companies have to adapt to a changing demand. This means that the effectiveness of the support policy will gradually decrease. The government, of course, cannot provide endless support, and at some point, a return to normal will be necessary. Because of the asymmetric impact of the crisis on the various sectors, there are both growing and shrinking sectors. This makes it all the more important for the instruments to support adaptability (e.g. funds and incentives for educational courses and retraining).

When interpreting GDP figures, it must be emphasised — even more so than usual — that GDP is not a measure of prosperity. Not everything of value can be measured. Things like neighbourly support, family visits and home schooling cannot all be captured in economic growth figures. The corona crisis has major consequences for things that affect quality of life, such as celebrating a wedding or jubilee, and going to festivals, theatres and concerts. And there are great concerns about loneliness in nursing homes and about children in vulnerable home environments.

Figure 1.4 In the baseline projections, only the government is contributing to growth in 2020; exports recover through trade



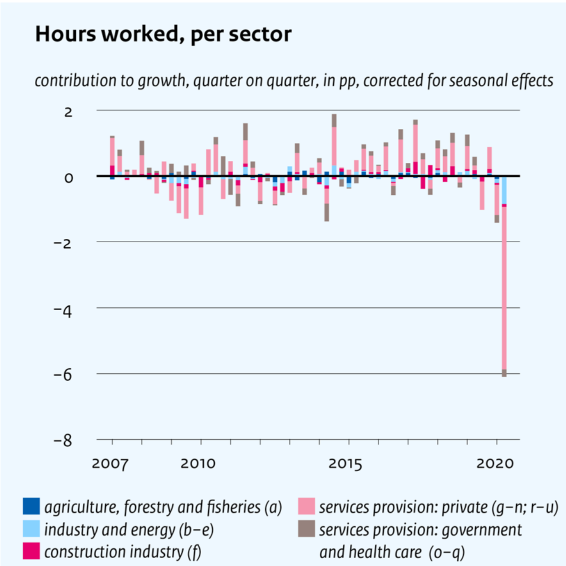
(a) The final and cumulated intermediate imports were deducted from the spending categories.
Source: CBS and CPB (link).

This year, only the government is contributing to growth; in 2021, only housing investments remain negative. Breaking down GDP development by spending category in the baseline projections shows that, this year, the government is the only party contributing positively. Underlying the increase in government spending, incidentally, is a decrease in health care consumption due to the delayed demand for care. This is counterbalanced by higher corona-related government spending (e.g. on personal protective equipment, implementation costs of the emergency package), as well as planned spending increases (e.g. on infrastructure, climate agreement). In 2021, goods export levels will recover in line with world trade, but the trade in services (especially tourism) will lag behind. Consumption will rebound after large spending reductions in 2020, but investments will recover to only a moderate degree, as companies are more pessimistic about their future turnover. Housing investments are the only spending category to remain negative in 2021 due to a decline in the numbers of transactions and slightly decreasing house prices. The housing market, generally, has a greater delayed response in times of economic crisis.

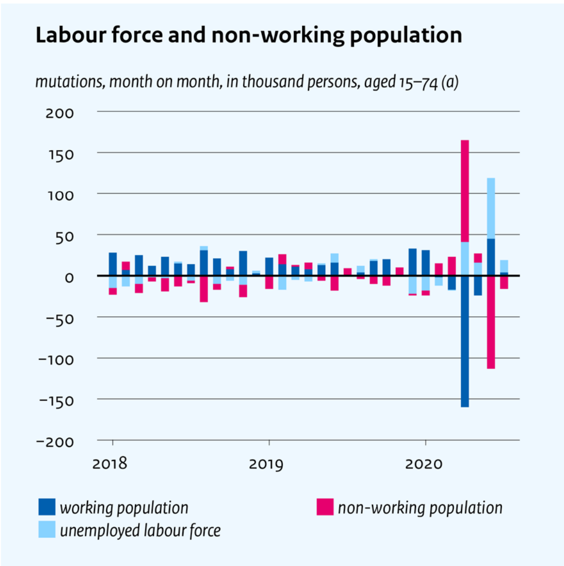
The labour market has been rather turbulent because of corona, but most of the blow is yet to come. Initially, a large number of the people who lost their jobs withdrew from the labour market, probably because of the poor prospects of finding a new job in the short term, and because physical contact restrictions were hampering their search process. Immigration has also been significantly lower. This caused the increase in unemployment to be only moderate, given the number of jobs lost. From June onwards, however, more people have been re-entering the labour market and unemployment is clearly on the rise. It is common for the labour market to reverberate after a shock. In the baseline projections, unemployment will peak above 6% in the second half of 2021. This level is lower than that during the previous crisis, and is relatively moderate, from a historical and international perspective, partly due to the favourable starting position of the Netherlands. Under the second-wave scenario, unemployment rises to almost 10%. This scenario assumes that the first shock has already weakened companies to such an extent that job losses on a larger scale can no longer be avoided.

With the NOW (Temporary Emergency Bridging Measure to Preserve Employment), the government has facilitated labour hoarding, but the effectiveness of this policy is gradually diminishing. For the time being, the support policy has enabled many companies to retain certain employees. In the first period (NOW 1.0, March–May), no fewer than 2.7 million employees were supported through the NOW. In the second period (NOW 2.0, June–September), the scheme was utilised to a lesser degree because there were fewer social distancing measures in place, but it nevertheless still involved an estimated one million people. Utilisation of the support scheme is expected to decline even further in the third period (NOW 3.0, October–June), due to further economic recovery and the gradual tightening of policy. The NOW has mainly protected people on permanent employment contracts. Young people, flex workers and freelancers, therefore, have been absorbing most of the blow.[1] Extension of the support policy reduces the increase in unemployment, which will be about half a percentage point lower in the baseline projections for 2021 than previously estimated in the August projections.

Figure 1.5 Turbulent trajectory on the labour market



Source: CBS (link).



(a) Season-corrected

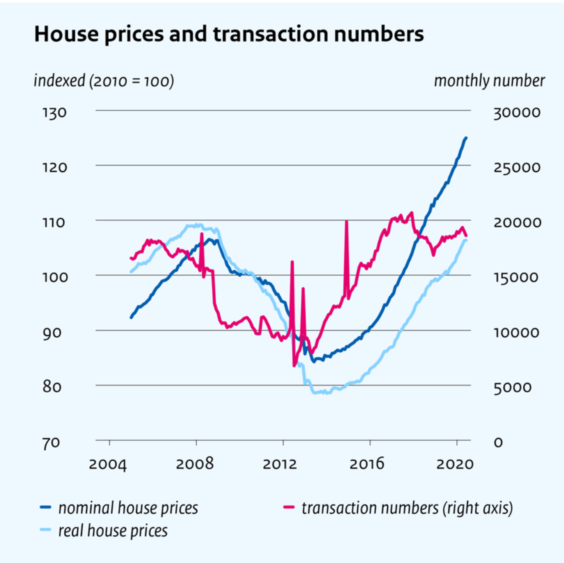
[1] See Section 1.2 for an analysis of the effects of corona on inequality.

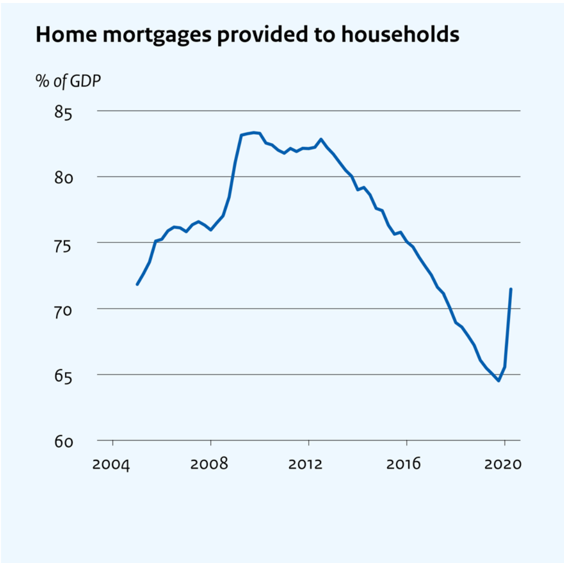
Incidentally, the spending impulse resulting from the additional expenditures that Cabinet decided on this summer, also contributes in this respect. However, the effect of the policy is gradually diminishing. As the crisis continues, businesses will be making certain adjustments. The gradual phase-out of the financial support policy and the more adaptive design of this policy are in line with this phase.

Productivity levels and the number of hours worked are suffering due to the recession, but they will recover next year. The decline has been the result of labour hoarding and, therefore, follows a pattern that is fairly common in times of recession. It is currently even stronger, as some sectors are less productive due to the physical contact restrictions that are still in place and because the government is still reimbursing most of the wage costs. Hours worked have decreased sharply, especially in private-sector services. This means that even if employment grows again, unemployment will continue to increase. This is because additional employment will mainly translate into more hours worked per employee, rather than into more people being hired. Incidentally, the number of hours worked has not fallen by as much as could be expected from the degree to which the NOW scheme has been utilised. This may be due to the fact that certain types of work continued during the lockdown, albeit at a lower level (shops would still open their doors from time to time, despite significant turnover losses) and because of non-turnover-related activities (using the lockdown to conduct certain renovations, such as painting the premises).

The response of the housing market to this crisis is still uncertain; there will be some cooling, but a repeat of the previous crisis is certainly not a given. Initially, the housing market held up remarkably well, with prices and transaction numbers increasing in the first half of the year. However, the housing market will not be able to completely escape the crisis and will eventually cool down. After all, households do have less to spend and population growth is lower because migrant workers are staying away. Nevertheless, a repetition of the collapse of the housing market, as was the case in the previous crisis, will not necessarily take place. The starting situation, this time, is different; for example, there are fewer households with very high mortgages in relation to the value of their properties, as a result of the stricter lending policies and tax-imposed annuity repayments. The total mortgage debt is also lower compared to the size of the economy. In addition, construction production is relatively low due to the sector's labour shortages of recent years and legal problems related to PFASs and nitrogen standards.

Figure 1.6 The crisis has not yet impacted the housing market and vulnerabilities are also smaller





Source: CBS, HDN (link).

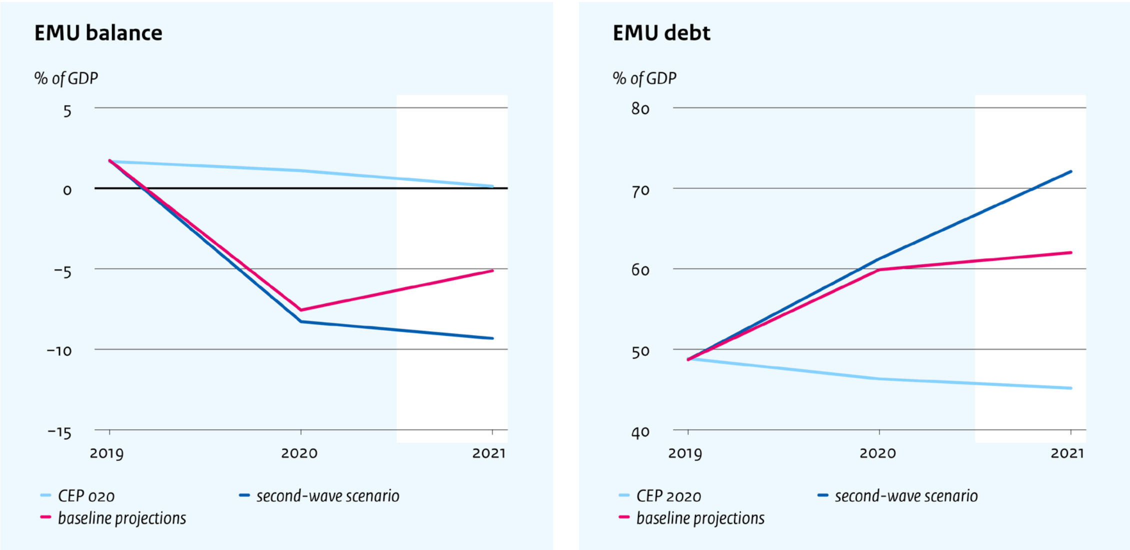
Wages are also responding with a certain delay; here, the impact of the corona crisis will not be clear until next year. Wage developments, for the current year, are largely predetermined by already implemented collective labour agreements. For next year, this development is much less fixed and will thus be far more moderate. Due to the great economic uncertainty, only few new collective labour agreements have been concluded in recent months. The projections assume that the options for lower wage level agreements under the NOW will not lead to a tangible effect, on a macro level.

Inflation is subject to various forces, and downward effects are expected to dominate. Initial inflation decreases were foreseen for 2020, because VAT increases were excluded from the figures of one year ago. The additional impact of the corona crisis is not unequivocal. The supply shock may cause certain prices to rise, while the demand shock will have a deflationary effect. The projections assume the demand shock to ultimately dominate, but the uncertainty surrounding the projected inflation level is clearly greater than normal. Oil price developments in recent months have also been extra turbulent due to strategic manoeuvres between oil-producing countries.

Static purchasing power developments, on average, will come to 2.2% for 2020 and 0.8% for 2021, but these percentages must be interpreted with caution. Because wages are reacting at a slower pace than inflation, static purchasing power developments are favourable this year, whereas next year wages will be more in line with inflationary development. The reduction in the financial burden, as announced last year, will further boost purchasing power in 2020, and the reduction that was agreed on in the Dutch Government's August decision will do the same for purchasing power next year. However, it cannot be emphasised enough that this concerns *static* purchasing power, which does not take into account the effects of corona on unemployment or lower turnover for the self-employed. In an exceptional crisis such as this one, the expressiveness of purchasing power figures is particularly limited.

Despite the new pension agreement, pension cuts are expected in 2021, as are increases in pension premiums. Under the pension agreement, the threshold for pension cuts in 2021 was lowered from 100% to 90%. However, a number of large pension funds are currently still below that level. The projections, therefore, refer to pension cuts that will affect a relatively large group of people. The average pension cut, at the funds that will need to implement such cuts, will be around 2% in 2021. Ultimately, the solvency ratio at the end of 2020 will be decisive. The low solvency ratios as a result of lower interest rates translate into rising pension fund premiums, at some of the pension funds.

Figure 1.7 Under the second-wave scenario, public finances in 2021 will deteriorate further



Source: CBS and CPB (link).

Table 1.1 Main data for the Netherlands, 2016–2021

	2016	2017	2018	2019	2020	2021
	mutations per year, in %					
International economy						
Relevant world trade volume goods and services	3.7	5.4	3.3	3.3	-9.3	6.8
Competitor prices (a)	-2.7	1.1	-0.8	3.0	0.2	0.0
Oil price (in USD per barrel)	43.8	54.3	70.9	64.3	41.7	45.1
Euro exchange rate (USD per euro)	1.11	1.13	1.18	1.12	1.12	1.14
Long-term interest rate, the Netherlands (level in %)	0.3	0.5	0.6	-0.1	-0.3	-0.3
Volume GDP and spending						
Gross Domestic Product (GDP, economic growth)	2.2	2.9	2.4	1.7	-5.0	3.5
Household consumption	1.1	2.1	2.2	1.5	-5.8	4.4
Public consumption	1.3	0.9	1.7	1.6	3.9	1.9
Investments (including stocks)	-6.7	4.2	3.9	3.6	-8.2	6.9
Export of goods and services	1.7	6.5	4.3	2.7	-5.2	4.7
Import of goods and services	-2.0	6.2	4.7	3.2	-3.6	5.8
Prices, wages and purchasing power						
Price level Gross Domestic Product	0.5	1.3	2.4	3.0	1.7	1.5
Export prices goods and services, excluding energy	-1.3	1.3	0.9	1.0	0.6	1.1
Price levels imported goods	-4.5	3.6	2.2	-1.1	-3.9	0.9
Inflation, Harmonised Index of Consumer Prices (HICP)	0.1	1.3	1.6	2.7	1.4	1.4
Wage rate business sector (per hour) (d)	0.7	0.9	1.9	2.4	4.0	0.3
Collective labour agreement (CAO) wages (c)	1.5	1.5	2.0	2.4	2.5	1.4
Purchasing power, static, median all households	2.5	0.2	0.0	1.0	2.2	0.8
Labour market						
Labour force	0.4	0.8	1.2	1.6	-0.1	0.6
Working population	1.3	2.1	2.3	2.0	-1.0	-1.0
Unemployed labour force (x thousand persons)	538	438	350	314	395	545
Unemployed labour force (in %)	6.0	4.9	3.8	3.4	4.3	5.9
Employment (in hours)	2.4	2.4	2.6	2.2	-3.6	1.2
Other						
labour income share (in %)	73.9	73.3	73.4	74.0	73.0	74.0
Labour productivity business sector (per hour)	-0.2	0.6	-0.1	-0.5	-1.4	2.8
Individual saving share (in % disposable income) (b)	3.9	3.0	3.2	3.1	9.2	7.1
Balance current accounts (in % of GDP)	8.1	10.8	10.8	9.9	8.3	7.6
	in % of GDP					
Public sector						
EMU balance	0.0	1.3	1.4	1.7	-7.6	-5.1
EMU debt (ultimo year)	61.9	56.9	52.4	48.7	59.9	62.0
Public financial burden	38.4	38.7	38.8	39.3	38.0	38.7
Gross public spending	44.0	42.9	42.8	42.4	50.3	48.3

(a) Goods and services, excluding natural resources and fuels.
(b) Level; disposable family income includes public savings.
(c) Previously, contract wages in the business sector.
(d) The NOW wage cost subsidy and the continuity contribution in health care have a 2.0 percentage points upward effect on businesses' wage rate mutations, in 2020, and a downward effect of 1.5 percentage points in 2021.

Public finances have absorbed most of the blow, resulting in a record-breaking deficit. The government is trying to cushion the impact by automatically expanding the budget in cases of economic setback. This automatic stabilisation mechanism has worked very well; the lower tax revenues and additional spending on unemployment benefit payments (WW) will negatively impact the balance by as much as 27.7 billion euros in 2020. On top of this, there will also be additional expenditures on the active support policy. Overall, 2020 will see a historically high deficit of almost 8%. In the baseline projections, the costs of support policy will be significantly lower in 2021, and economic growth will once again generate more tax revenues (the recovery nevertheless will not be proportional due to the compensation of losses and progressiveness in the tax system). However, this will be counterbalanced by additional expenditure and a reduction in the financial burden. As a result, in the baseline projections, the deficit will decrease to 5% in 2021. The second-wave scenario assumes the support policy to be continued throughout 2021, with further deterioration of tax revenues. In such a case, the deficit on the government budget would be more than 9% by 2021.

Government debt will remain bearable under the second-wave scenario, which is why, for the time being, there is no need for spending cuts or increases in financial burden. The debt ratio will rise sharply in 2020 due to the above-mentioned balance development and the denominator effect of a shrinking economy. The tax deferrals granted to entrepreneurs (which are not visible in the deficit development) will cause the debt to rise in 2020 and decrease again in 2021. Partly as a result of this difference between cash flow and transaction basis, the baseline projections expect the debt ratio to stabilise as early as next year. Under the second-wave scenario, the debt ratio increases further to 72% by the end of 2021. However, even this level would not become a cause for concern, according to the economic literature. In the Netherlands, the debt ratio was higher in the early 1990s, and is currently also significantly higher in many other European countries without leading to financing problems. For the time being, therefore, the state of public finances does not call for spending cuts or increases in financial burden, in the short term. This would unnecessarily hamper economic recovery, given the exceptional economic downturn.[2]

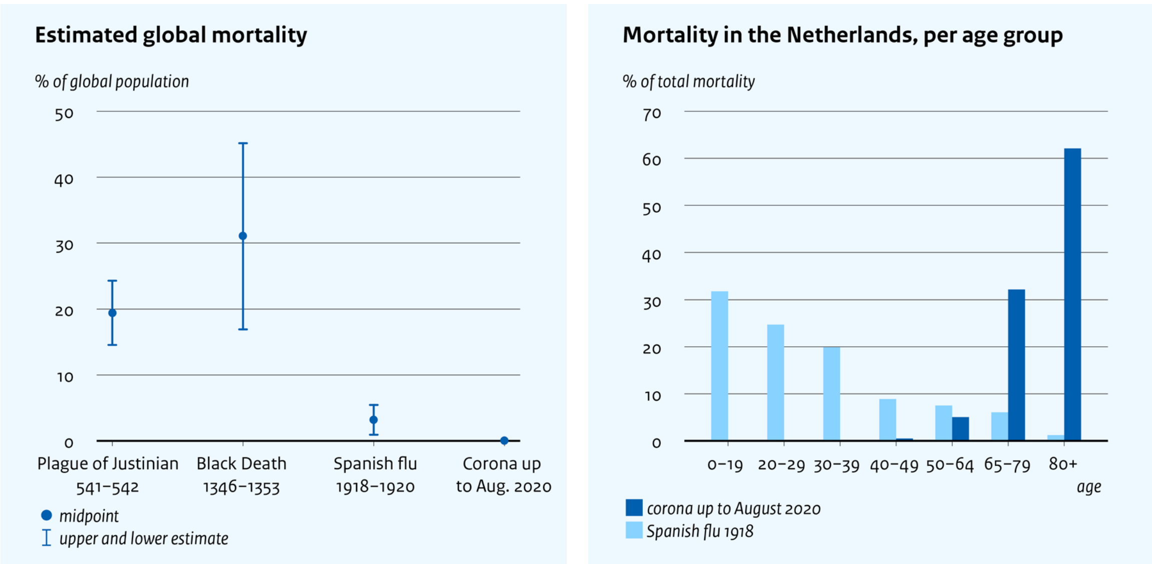
1.2 Corona hits weak spot

The corona crisis does not affect all people in the same way. What does this mean for socio-economic inequality? A quick look at CPB's latest projections of purchasing power may lead to confusion: how can there be a big plus during what is considered the worst economic year ever? CPB hastens to put this into perspective; it is about *static purchasing power*, which shows what is likely to happen, on average, under unchanged personal circumstances. So, no job losses, no family expansion, no divorce, and so on. Of course, the point is that, for many people, it is precisely in times of crisis that personal circumstances deteriorate, and this fact is not included in static purchasing power figures. Nevertheless, the projections also show that, even during a crisis of this magnitude, there are people whose income will increase. The coronavirus crisis, inherently, has very different effects on different parts of the economy. People in permanent employment in sectors that are barely or not at all affected (e.g. government, supermarkets, delivery services) will probably see an increase in their disposable income. Flex workers and self-employed people in, for example, the travel or events industry have a completely different perspective. The question is whether these unequal impacts, on balance, will also affect inequality: will the strongest shoulders carry the heaviest burden, or will vulnerable groups particularly experience negative impacts?

[2] 16th Study group on budgetary margins ('Studiegroep Begrotingsruimte', 2020), Letter about the postponement of the final advice this study group has been requested to provide (link).

Theoretically, the effect of a pandemic on inequality can go either way, but in this case, the likely outcome is one of greater inequality. From a historical perspective, pandemics often reduce inequality. Perhaps the strongest example of this is the plague epidemic of the 14th century, which, according to economic historians, contributed to the end of the feudal system of lords, vassals and serfs in north-western Europe.[3] However, this took place in a very grim way: there were so many deaths that the surviving farm labourers ended up in a position of considerably greater bargaining power. The Spanish Flu of a century ago — which made the most victims among relatively young people, while the First World War had already slashed their numbers — also had an upward effect on wage levels. Fortunately, to date, COVID-19 has claimed far fewer victims than those previous pandemics. And, because mortality occurs predominantly among the elderly, the effect on the labour force is relatively small. As a result, the greatest economic impact of the current pandemic is not so much on public health as on the efforts to prevent any such impact, with measures including physical contact restrictions and the social distancing that people themselves are adopting in a bid to limit exposure. A comparison with more recent, less lethal epidemics is therefore likely to be more meaningful. Research into countries that were relatively hard hit by, for example, SARS and MERS, shows that income inequality increased at the time.[4] But such comparisons are also imperfect, if for nothing else than for the more limited scale of those epidemics. In addition to the specific characteristics of the virus, the existing institutional and economic structure is also important for the level of impact on inequality. Policy responses also play an essential role. In order to assess the effects of the coronavirus crisis on inequality, we must therefore look more closely at who is affected the most severely, and what the consequences are, from a Dutch perspective.

Figure 1.8 Number of victims not comparable to other pandemics; they are older than during Spanish Flu

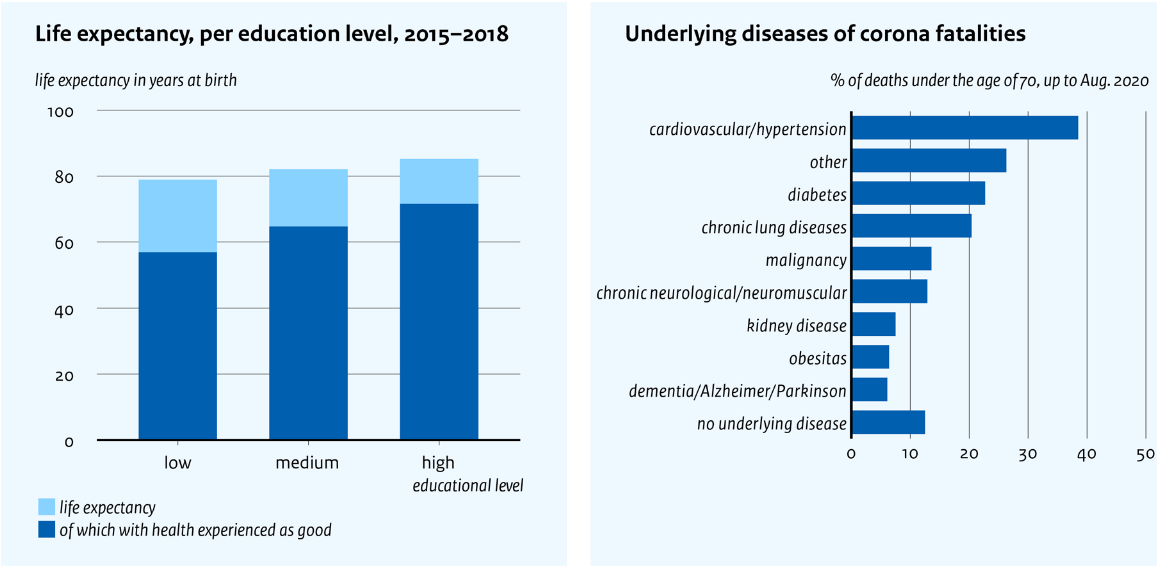


Source: own calculations based on several estimations of global deaths and population (left); CBS and RIVM (right), (link).

[3] Milanovic, B. (2016), Global inequality: A new approach for the age of globalization, Cambridge, MA: Harvard University Press.
[4] Furceri, D., P. Loungani, J.D. Ostry and P. Pizzuto (2020), Will Covid-19 affect inequality? Evidence from past pandemics, *Covid Economics*, 12, pp. 138–157, link.

The fact that the macroeconomic effects of the health damage are limited does not alter the fact that the burden of disease is not equally distributed. There is a strong correlation between health and socio-economic position, in the Netherlands. Higher educated people, on average, live six years longer than lower educated people. The difference in how long they *feel* healthy is even 14 to 15 years.[5] Lifestyle and aptitude play a role here, but also the quality of people's environment, such as their level of exposure to air pollution. Because of these differences in people's general circumstances, it is likely that COVID-19 will lead to an increase in inequality. After all, those with poorer health run a greater risk of becoming seriously ill and dying.[6] This effect is exacerbated even further if people with a lower socio-economic status are also more at risk of being exposed to the virus; for example, because they are more likely to have jobs in which working from home is not possible, are dependent on public transport, work in poorer working conditions, or live more often in densely populated neighbourhoods. In the United States — where such differences are more pronounced — there are major concerns about these aspects.[7] There are also indications that the same would apply in the Netherlands — for example, with respect to the working and living conditions of workers (often migrants) in the meat processing industry.[8] Inequalities in mental health can also be exacerbated by corona. People on a lower income, those with disabilities and social benefit recipients are all more likely to feel threatened by corona.[9]

Figure 1.9 Health is unequally distributed; corona has greater impact on people who are in poor health



Source: CBS and RIVM, (link).

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[5] Broeders, D., D. Das, R. Jennissen, W. Tiemeijer and M. de Visser (2018), From difference to potential. A realistic perspective on socio-economic health differences (*Van verschil naar potentieel. Een realistisch perspectief op de sociaaleconomische gezondheidsverschillen*, in Dutch), WRR Policy Brief, link.
[6] Zheng, Z., F. Peng, B. Xu, J. Zhao, H. Liu, J. Peng, Q. Li, C. Jiang, Y. Zhou, S. Liu, C. Ye, P. Zhang, Y. Xing, H. Guo and W. Tang (2020), Risk factors of critical & mortal COVID-19 cases: A systematic literature review and meta-analysis, *Journal of Infection*, 81, pp e16–e25, link.
[7] Blow, C.M. (2020), The racial time bomb in the Covid-19 crisis, The New York Times, 1 April 2020, link.
[8] Working from home, in the Netherlands, occurs most in the highest professional levels. See CBS (2020), ICT professionals most often work from home during the coronavirus crisis (ICT'ers werken vaakst vanuit huis tijdens coronacrisis, in Dutch), link.
[9] Van Bochove, M. (2020), Handling fear, stress and risks (*Omgaan met angst, stress en risico's*, in Dutch), In: G. Engbersen and T. Wentink (Reds.), City under threat (*De bedreigde stad*, in Dutch) Rotterdam: Kenniswerkplaats Leefbare Wijken, link.

On the labour market, the corona crisis is deepening already existing fault lines. The Dutch labour market is characterised by a sharp dichotomy between people with a high level of job and income security and those without such security.[10] This is not news in itself, but the corona crisis re-emphasises the vulnerability of this market. It means that the largest part of any economic shock is absorbed by a specific group, namely that of temporary contract workers, contingent workers and freelancers. Companies that tighten their belts will first part company with flex workers and freelancers and not renew any temporary contracts. This can already be seen in today's figures; unemployment has risen sharpest among young people, because relatively often this group is not in permanent employment. Here, it is important to note that the choice between permanent employment and freelance work is not always a voluntary one. Self-employment, rather, reflects a lack of bargaining power, in certain sectors.[11]

The groups that are affected the most run a relatively high risk of facing particularly financial problems. Those at risk, often, include students, youths, migrants, singles and people on a relatively low income. These groups often have few other sources of income to fall back on.[12] In addition, people on a relatively low income have little in the way of financial buffers. A stress test shows that, in absence of the additional income support for the self-employed (TOZO) that was introduced because of corona, about 10% of self-employed workers would no longer be able to pay their fixed costs within three months of losing part or all of their income.[13]

Moreover, the crisis amplifies the effects of discrimination on the labour market, with a last-in-first-out strategy. There is a certain discrimination on the Dutch labour market, where applicants with a migration background are receiving fewer responses than equally qualified applicants with a Dutch background. This effect is strongest for groups of non-western origins, particularly African and Arabic.[14] Because these groups are at a disadvantage on the labour market, they are more likely to have short-term or temporary contracts. They are the last to be hired in times of economic boom and the first to go in times of crisis.

Because support policy was based on the existing situation, it unintentionally increases inequality on the labour market. The emergency packages have been put together rather quickly, which could only be done by basing them on this existing situation. Companies that have lost revenue can apply for a subsidy in the NOW to prevent dismissals. Workers who stay employed because of this scheme but for whom there is little work, have been receiving 100% of their wages over the last six months, something that can be considered generous from an international point of view. A voluntary pay cut would provide better incentives for job reorientation and might also be fairer, but this would involve many implementation problems and legal issues.[15] Temporary job contracts however, are often not renewed. Those workers are therefore the first to lose their job, often, they have only limited entitlement to unemployment benefits; and the first corona-related unemployed people have already ended up on welfare. In the current crisis, there were good economic arguments for extending the unemployment benefit entitlement for such groups, but this would have required a separate administrative process, the implementation of which is difficult to imagine. The self-employed receive income support via TOZO, but this is at subsistence level, and tested for partner income. Although support policy is both necessary and generous, the unintentional side effect is an increase in inequality on the labour market.

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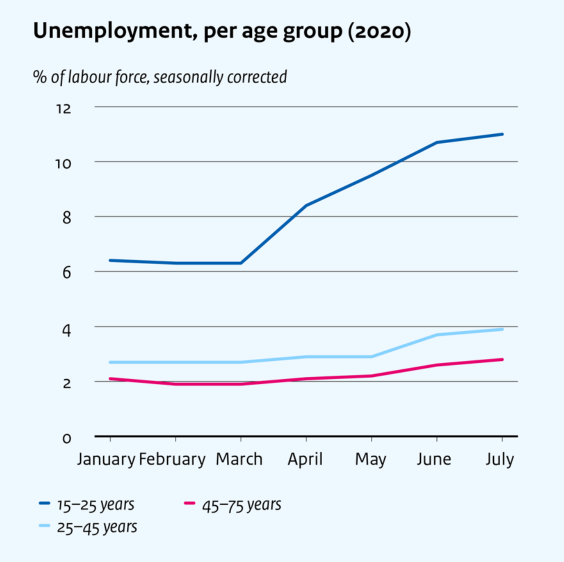
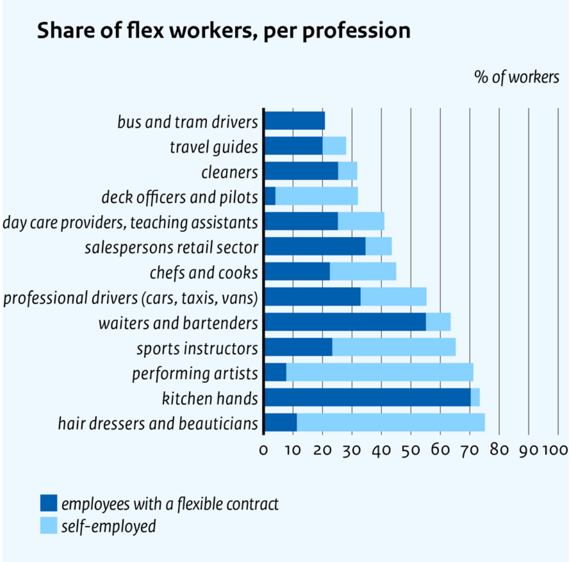
[10] Commissie Regulering van Werk, 2020, In wat voor land willen wij werken? Naar een nieuw ontwerp voor de regulering van werk, link.
[11] Dutch Government (2015), IBO self-employed without personnel (*IBO zelfstandigen zonder personeel*, in Dutch), link.
[12] Van den Berge, W., S. Rabaté and L. Swart (2020), Crisis on the labour market; who are the most at risk? (*Crisis op de arbeidsmarkt: Wie zitten er in de gevarenzone*? in Dutch), CPB corona publication, link.
[13] Vlekke, M., H-W. de Boer, J. Weda en A. van Geen, 2020, Stress Test Households (*Stresstest Huishoudens* in Dutch), CPB/AFM corona publication (link).
[14] Thijssen, L., M. Coenders and B. Lancee (2019), Ethnic discrimination on the Dutch labour market; differences between ethnic groups and the role of information available on job applicants, in Dutch (*Etnische Discriminatie Op de Nederlandse Arbeidsmarkt: Verschillen Tussen Etnische Groepen En de Rol van Beschikbare Informatie over Sollicitanten*, in Dutch), *Mens en Maatschappij*, 94, pp. 141–176
[15] Jongen, E. and P. Koning (2020), Lessons for the NOW (*Lessen voor de NOW*, in Dutch), CPB corona publication, link.

Figure 1.10 Young people impacted the most, flex work is the norm in some of the most severely affected sectors





Source: CBS, (link).

In the long term, too, the corona crisis may increase inequality by exacerbating the already existing unequal opportunities in education. People born with a silver spoon in their mouth, have greater chances of a successful school career and, ultimately, a good income.[16] Closing the schools during the lockdown has probably exacerbated these already unequal opportunities. For example, the corona-related cancellation of the final written test in primary education (which, in the Netherlands, largely determines a pupil's subsequent level of secondary education) has meant that especially students with a migrant background and those of less well-educated or lower earning parents have missed out on receiving a higher secondary school advice.[17] But corona has not only affected children in the final year of primary school, it probably also increases inequality in the other years. After all, home schooling is a lot more difficult for those living in small homes, those who have less access to digital or other educational resources and for parents who have a lower education level themselves.[18] Indicative, in this context, is research into the so-called 'summer learning loss', which shows that students lose certain acquired skills as a result of an interruption in their schooling, and that this effect is stronger in pupils with an already existing learning deficit.[19] In addition, the 'better' schools seem to be more successful in organising distant learning.[20]

[16] CPB (2020), Unequal opportunities are missed opportunities (*Ongelijke kansen zijn gemiste kansen*, in Dutch, In: CPB (2020), Central Economic Plan 2020, link.
[17] Swart, L., D. Visser, M. Zumbuehl and W. van den Berge (2020), Cancellation of the group 8 final written test may increase inequality (*Schrappen eindtoets groep 8 kan ongelijkheid vergroten*, in Dutch), CPB corona publication, link. Incidentally, cancelling the central final exams has quite the opposite effect, as on balance this benefits pupils with a non-western migration background and pupils with parents with a lower or average level of education. See Swart, L., D. Visser and M. Zumbuehl (2020), Impact of cancelling central exams without additional measures (*Effect schrappen centraal examen zonder aanvullende maatregelen*, in Dutch), CPB corona publication, link.
[18] Bol, T. (2020), Inequality in home schooling during the Corona crisis in the Netherlands: First results from the LISS Panel, Working Paper, 30 April 2020, link
[19] Education Council (2020), Advice on anticipating the coronavirus crisis consequences for education (*Ondervangen gevolgen coronacrisis voor het onderwijs*, in Dutch), link.
[20] Education Council (2020), Looking ahead for younger generations (*Vooruit zien voor jonge generaties*, in Dutch), link.

What does this mean for policymakers? The corona crisis affects existing vulnerabilities in the Dutch economy and exacerbates existing unequal opportunities in education. In the short term, the government can support the most affected groups by investing in matters such as education and employment guidance, and by providing help in cases of poverty and problematic debt, the third instalment of the support policy indeed contains elements of this.[21] In the event of new physical contact restrictions needing to be implemented, the effect of school closures on inequality of opportunity may be taken more explicitly into account in prioritisation. At the same time, and however useful they may be, such policies should ultimately be qualified as symptom-relief measures. Addressing the underlying vulnerabilities themselves is the real challenge, and relates to reducing the differences between permanent employment and flex work, combating ostensible self-employment and discrimination, reducing the differences in health levels and working conditions between the groups with high and low socio-economic status. Although this would come too late for the current crisis, it could ensure that society is more resilient by the time the next crisis hits.

[21] For policy options, see CPB (2020), Promising labour market policy; an update of active labour market policy (*Kansrijk arbeidsmarktbeleid: Update actief arbeidsmarktbeleid*, in Dutch, link) and CPB/SCP (2020), Promising poverty policy (*Kansrijk armoedebeleid*, in Dutch, link).