



Uncertain world | *Stable  
Dutch economy*

**Central  
Economic  
Plan  
2016**

***Chapter 1***  
**(translation)**



## Summary

The moderate rate of economic recovery is continuing, on a global level, with a 2.9% growth in the world economy projected for this year, and 3.2% for the next. In the emerging economies economic growth will slow down, and in the United States leading indicators point to it levelling-off. In the eurozone, growth is progressing slowly but surely, with 1.6% this year and 1.7% in 2017. The world trade relevant for the Netherlands will gradually increase to 4.4% by next year. Price levels are determined by the recent continuing drop in resource prices and particularly the oil price, a major cause of the low inflation rate in many countries.

Uncertainty around the international situation is substantial, and the risks are predominately downwards. Financial markets are nervous, due to various uncertainties. The resulting continuing volatility on financial markets negatively affects the investment climate. A Brexit would have a future negative impact on both the European and the Dutch economy, as would a discontinuation of the Schengen Agreement in response to the ongoing influx of asylum seekers.

The Dutch economy is recovering from the Great Recession and the euro crisis at a steady but unspectacular pace, with a 1.8% growth projected for this year and 2.0% for 2017. Basic growth levels in both years are comparable; lower natural gas production will slow economic growth down by 0.2% this year. In both years, all spending categories will contribute. Consumption will increase because of a rise in real disposable incomes, a higher employment level, and the delayed impact of the 5-billion-euro package of tax relief. The increase in production, in both years, is coupled with an increase in employment, which, in turn, is driven by the growth in the market sector. Labour supply is also increasing, but less so than employment. On balance, unemployment will decrease slightly, to 6.3% in 2017.

Purchasing power is projected to increase this year by 2.3% because of low inflation, the ensuing substantial rise in real wages, and the reduction in financial burden through the 5-billion-euro package of measures. The purchasing power of the employed is increasing relatively strongly. For the median household, it will increase next year by 0.2%. The 5-billion-euro package of measures will no longer provide an impulse to purchasing power and real wage increases will be smaller than this year, due to increasing inflation.

The continuing moderate economic recovery will cause the government deficit to decrease, from 1.9% of GDP last year to 1.7% in 2016 and 1.2% in 2017. The continuing recovery, together with decreasing unemployment, will lead to lower expenditure on unemployment benefits. Lower natural gas revenues, due to lower production levels and a lower price, will attenuate the deficit reduction. The structural government deficit is projected to improve in 2017 by 0.4%. The budgetary task based on EU budgetary regulation in 2017 is expected to require an improvement of 0.6% of GDP, and corrected public spending will surpass the maximum growth level.

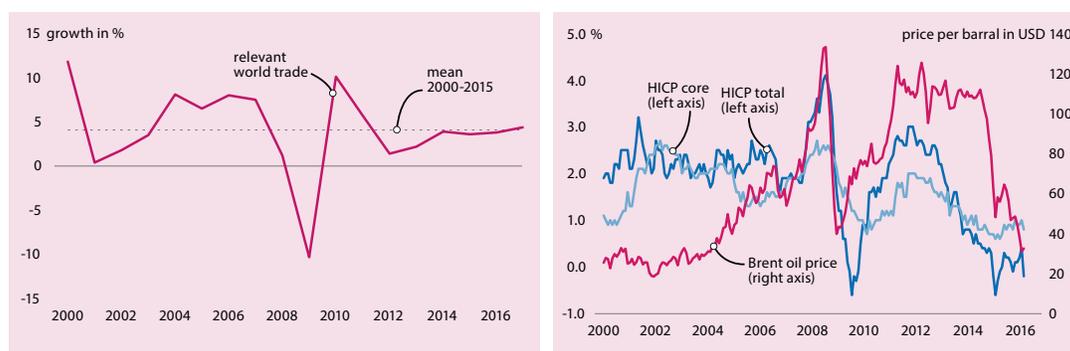
The arrangements that redistribute income over the life course are addressed in the analysis section. One of its conclusions is that current policy on pensions and homeownership hinders the distribution of consumption over the life course. This also causes the Netherlands, as a whole, to be vulnerable. On the one hand, there are large amounts in pension capital exposed to financial market risks, while, on the other, there are large mortgage debts. Changing these arrangements is complex; it requires making fundamental choices about both pension and tax systems, and in addition is bound by the possibilities and impossibilities of how these systems can be executed. Options include limiting the required mortgage repayment to a maximum of 50% under equal decrease in financial subsidies, and enabling a lower increase in pension savings, possibly in combination with a required level of mortgage repayment.

# 1 The economy in 2016 and 2017

The moderate level of economic recovery is continuing on a global level, despite the recent slowdown, with a 2.9% growth in the world economy projected for this year and 3.2% for the next. The most recent realisations of GDP growth over the fourth quarter of 2015 show disappointing results, across the board. The global growth level is projected to be not much higher than that of last year – the year that had the lowest economic growth since the crisis year of 2009. In emerging economies it is slowing down, and leading indicators for China and Russia, from the most positive perspective, show tentative signs of careful stabilisation. Advanced economies show a modest recovery, with the United States in the lead. Leading indicators point to growth in the United States levelling off, and to a more or less stable growth in the eurozone. The projections for the eurozone indicate a steady but unspectacular growth level of 1.6% this year and 1.7% in 2017.

The world trade relevant to the Netherlands shows a comparable picture (Figure 1, on the left), with moderate growth levels, from a historical perspective, both last year (3.6%) and this year (3.8%). Under the influence of a steadily continuing economic growth in the advanced economies, in particular, next year will see a slight acceleration to 4.4%, equal to the average since the turn of the century. Uncertainties around the international situation are great (see text box).

**Figure 1 Moderate growth in relevant world trade (left); low oil price contributes to low inflation in the eurozone (right)**



Source: OESO, IMF, CPB ([link](#))

The depreciation of the euro was halted last year. Price-determining factors are the recent continuing drop in resource prices, particularly the oil price.<sup>1</sup> Fuel import prices, in euros, therefore will experience a substantial drop, as they did in 2015. This is a major reason for the eurozone's low level of inflation. Inflation in the eurozone has been low and declining for some time. Corrected for decreases in the price of energy and unprocessed foods, inflation has been relatively stable since 2015 and even shows a slightly upward trend (see Figure 1, on the right). According to the projections, inflation in the eurozone will come to 0.5% this year. For next year, it is projected to increase to 0.9%, among other things due to the fact that

<sup>1</sup> Projections on the foreign situation (exchange rates, oil price, interest rates) are based on realisation data that became available in the fourth week of 2016.

the long-term impact of lower oil prices has stopped. The (five-year) inflation forecast, a point of reference for the ECB's monetary policy, is currently at around 1.5%.

Financial markets are nervous. Worldwide, share prices have gone down, recently, under the influence of uncertainty about the growth in emerging economies, particularly in China, a strongly declining oil price, and uncertainty about what would be an effective monetary policy response. Banking shares have suffered in particular, and *credit default swaps* for banks have increased. This points to continued uncertainty about the solidarity within the banking system. The central banks' monetary policy in the advanced economies continues to be stimulating. The depository interest was lowered further in Japan (February) as well as in the eurozone (December). The policy interest rate was raised in the United States, in December, but any further increases seem unlikely in the short term. The more flexible monetary policy and investors fleeing to safe havens go hand in hand with historically low and in many cases even negative (short-term) interest rates.

Specific risks in the international environment are mostly downwards. Volatility on financial markets in response to the uncertainties about economic developments in China, the oil price and the rate of normalisation of US monetary policy, also pose a risk. Continued volatility negatively affects the investment climate. On 23 June of this year, the United Kingdom will hold a referendum on its EU membership. A Brexit, in the long term, would have a negative impact on the European and the Dutch economy, through trade. In addition, there is the risk of the increasing influx of asylum seekers from the Middle East and northern Africa leading to nullification of the Schengen Agreement. This would slow down free travel of people and goods within the EU, with a negative impact also on the Dutch economy.

## 1.1 The Dutch economy

The Dutch economy has been recovering steadily from the great recession and the euro crisis, with a projected growth of 1.8% for this year and 2.0% for 2017. Economic development is not spectacular, but it is catching up. For both years, the Dutch economy is projected to grow faster than that of the eurozone. As mentioned, uncertainties currently are relatively large and negative risks dominate, particularly in the international environment (see text box). Figure 2 (right-hand side) shows the uncertainty around the point estimation of GDP growth in a fan chart, graphically depicting the likelihood of the various outcomes.

Both this year and the next, all spending categories will contribute to growth (Figure 2, left-hand side). This year, the contribution of domestic spending to growth is projected to be greater than to exports, similar to last year's situation. The export contribution is particularly lower due to lower natural gas production; more gas is being imported than exported.

## Uncertain world

At the beginning of this year, financial markets were unstable. Shares went down, worldwide, but have since partly recovered. Particularly oil products, mining companies and European banks have been reduced in value. The instability seems to be caused by a multitude of uncertainties: those around the prospects for growth in the United States, Europe, Japan and China; around the oil price development and the consequences for the world economy if the price remains at the current low level for a longer period of time; around a possible Brexit; and around the ability of the financial system in Europe to absorb new shocks. Then there is also the policy uncertainty about the exchange rate in China, the normalisation of US monetary policy and the continuing quantitative easing in the eurozone and Japan. Many of these concerns are not new, but the mood was more positive late last year.

It is a fact that, in general, growth figures over the last quarter of 2015 were lower than expected and that the prospects for emerging economies have diminished further. For this reason, the OECD once again reduced its growth projections in February, while increasing the emphasis on the downward risks. CPB's CEP projections on relevant world trade for 2016 also are lower than its December projections (3.8% instead of 4.3%), and for 2017 include a recovery to 4.4%. In addition, global GDP is lower than in the previous projections; particularly due to the bleaker prospects for the emerging economies (with the exception of China).

What would be the impact on the Dutch economy if a large number of developed countries and China postpone their domestic spending (their consumption of durable goods and investments)? What if spending levels in the large developed countries would decrease by 1% of GDP – as they do during a typical recession – and in China by 2% of GDP (a)?

Growth in the Netherlands would be affected by 0.2% in 2016 and 0.5% in 2017. Particularly exports would decrease, considerably, due to a decline in relevant world trade. In 2017, consumption and investments would also be affected. The decline in international demand would lead to a decrease of about 1% in competitor prices and import prices in 2017. As a result, inflation in the Netherlands would also be lower.

### Uncertainty variant

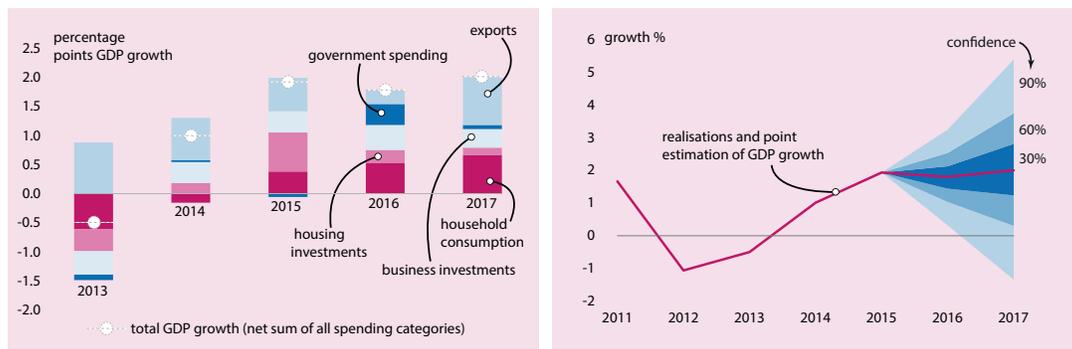
	Not accumulated	
	2016	2017
Relevant world trade	-0.9	-1.4
Competitor prices	-0.1	-1.0
Price level imported goods	-0.2	-1.1
Gross Domestic Product	-0.2	-0.5
Household consumption	0.0	-0.2
Investments (including stocks)	0.0	-1.5
Exportation of goods and services	-0.7	-1.2
Importation of goods and services	-0.5	-1.2
Inflation, Harmonised Index of Consumer Prices (HICP)	-0.1	-0.5
Employment (hours)	-0.1	-0.3
Unemployed labour force (in % of labour force)	0.1	0.3
EMU balance (in % of GDP)	-0.1	-0.3

(a) IMF, 2009. World Economic Outlook: Crisis and Recovery, International Monetary Fund, Washington D.C. ([link](#))  
The average multi-annual growth over the past 45 years was 3.5%. Growth during an average period of recession (five periods since 1970 were identified by the IMF) is 2.5%.

Domestic spending is projected to decrease next year, due to lower growth in investments and a slightly lower level of government spending. In addition, exports will increase next year to 4.1%, due to a slightly accelerating world trade and the absence of the attenuating effect of a lower natural gas production on exports.

For this year, consumption is projected to grow by 1.6%, and by 2.0% for 2017. Real disposable income will increase, this year, because of the rise in real contract wages, increasing employment, and the 5-billion-euro package of measures. The slight decrease in average pension premiums due to a lowering of pension savings will also have a positive effect, this year. Part of this addition in disposable income will be saved. In 2017, the 5-billion-euro package of measures will still have a delayed positive impact, and the increase in employment will also support growth. For next year, the improving housing market is projected to contribute to the increase in consumption through positive capital impacts. On the other hand, there is the increase in pension fund premiums next year, in response to the decrease in both interest rates and share prices. In both years, there will hardly be an indexation of pensions.

**Figure 2 All spending categories (a) contribute to growth (left), uncertainty around growth projections (right)**

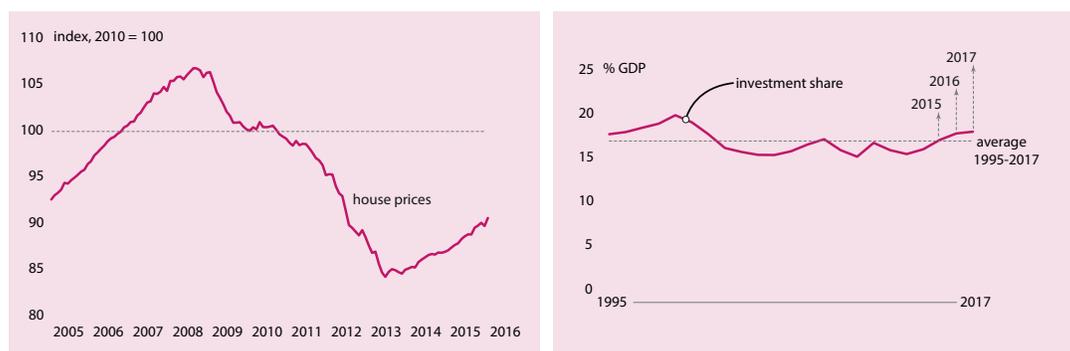


(a) Contribution by government spending to GDP growth concerns only the direct spending effects of government consumption and investments. Other government expenditure, including income transfers and subsidies, may contribute to growth via spending by households and companies. The latter also applies to taxation. Source: CPB calculations, based on CBS data ([link](#)).

Recovery of the housing market, which began in 2014, is projected to continue. According to the projections, the pace of house price increases will accelerate slightly, in 2016 and 2017 (Figure 3, left-hand side). Because the supply of houses will become less abundant, the chances of price increases gradually become higher. The increase in the number of transactions of existing privately owned houses, after having peaked over the last years, will continue at a more moderate level. The catch-up in demand and the increase in the number of privately owned houses may cause a slight further increase in the number of transactions, in comparison with the level of before the crisis. For this year, housing investments are projected to grow by nearly 8%, partly as a result of an overflow of high investments of last year. Investments will level off to 4%, next year. The trend in issued building permits and new housing sales will remain positive.

A substantial 6% increase in investments is projected for this year, following last year's strong increase of 7.2%. This is partly due to the increased capacity utilisation of the last years. In addition, the lower resource and energy prices, in the short term, will not be incorporated in the retail prices, causing the profitability of companies to improve and the possibilities for investments to increase. And there is the additional impulse induced by low financing costs due to low interest rates. Because of the more than average growth in investments in 2015 and 2016, the investment share over 2016 is projected to already surpass the multi-annual average (Figure 3, right-hand side). The investment climate will thus be sufficient to keep production capacity in line with demand. The need to further step up production capacity will thus be more limited, causing investment growth to level off in 2017 to 4.2%.

**Figure 3 Recovery of house prices continuing (left); investment share above the multi-annual average (right)**



Source: CPB adaptation of CBS data ([link](#))

The growth in production will be realised almost entirely in the market sector. The decision to limit natural gas extraction from the Groningerveld to 27 billion cubic metres will slow growth down by 0.2 percentage points this year. Health care, in both this year and the next, will positively contribute to total production.

## 1.2 Labour market

Increased production is coupled with an increase in employment in the market sector of 1.4% in 2016 and 1.2% in 2017. As labour demand has a delayed response to production, the growth in employment in the market sector is expected to be somewhat lower next year, compared to this year. Employment will grow this year in both the market sector and the public sector. In 2017, the increase will be fully the result of increasing employment in the market sector. The slight rise in employment in health care will then be compensated by a decrease in government employment. At the same time, the labour supply is expected to increase in both years, due to both structural and policy factors. The structural factor is the increased labour participation of women and people over the age of fifty. Policy contributes to the increase in the labour supply mainly via the 5 billion-euro package of measures to reduce the financial burden, and by raising the state pension entitlement age (AOW age). The larger influx of asylum seekers will not yet have its effect on the labour supply in 2016 and

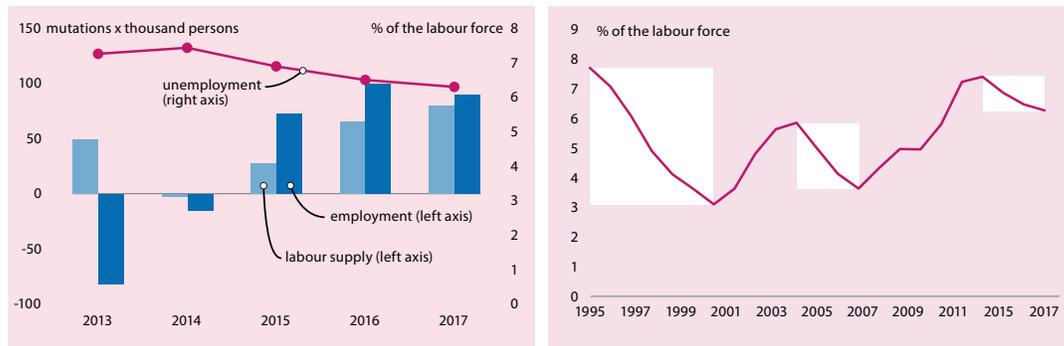
2017, as those that do obtain a residence permit first have to focus on integration before they enter the labour market.

**Table 1 Main data for the Netherlands, 2012-2017**

	2012	2013	2014	2015	2016	2017
mutations per year in %						
<b>International economy</b>						
Relevant world trade volume of goods and services	1.4	2.2	3.9	3.6	3.8	4.4
Competitor prices (a)	5.3	-3.2	-1.3	6.2	-1.3	0.2
Oil price (in USD per barrel)	111.7	108.7	99.0	52.5	31.7	37.7
Euro exchange rate (USD per euro)	1.28	1.33	1.33	1.11	1.09	1.09
Long-term interest rate in the Netherlands (in %)	1.9	2.0	1.5	0.7	0.6	0.6
<b>Volume GDP and spending</b>						
Gross Domestic Product (GDP, economic growth)	-1.1	-0.5	1.0	1.9	1.8	2.0
Household consumption	-1.2	-1.4	0.0	1.6	1.6	2.0
Government consumption	-1.3	0.1	0.3	-0.3	2.0	0.2
Investments (including stocks)	-6.2	-5.3	2.7	7.2	6.0	4.2
Export of goods and services	3.8	2.1	4.0	4.2	3.6	4.1
Import of goods and services	2.7	0.9	4.0	4.9	5.0	4.5
<b>Prices, wages and purchasing power</b>						
Price level Gross Domestic Product	1.4	1.4	0.8	0.5	1.1	0.9
Export prices goods and services, excluding energy	1.2	0.5	-0.7	0.7	-0.8	0.5
Import price levels	3.2	-1.6	-3.1	-5.5	-7.3	1.8
Inflation, Harmonised Index of Consumer Prices (HICP)	2.8	2.6	0.3	0.2	0.3	1.0
Contract wages market sector (d)	1.6	1.2	1.0	1.2	1.5	1.7
Purchasing power, static, median all households	-1.9	-1.3	1.4	1.0	2.3	0.2
<b>Labour market</b>						
Labour force	1.5	0.8	-0.4	0.4	0.3	1.2
Working population	0.6	-0.8	-0.6	1.0	0.7	1.5
Unemployed labour force (x thousand persons)	516	647	660	614	580	570
Unemployed labour force (in % of labour force)	5.8	7.3	7.4	6.9	6.5	6.3
<b>Market sector (b)</b>						
Production	-1.2	-1.2	1.9	2.7	2.3	2.6
Labour productivity (per hour) (d)	-0.1	-0.2	1.4	1.3	0.8	1.4
Employment (in hours) (d)	-1.2	-0.9	0.5	1.4	1.4	1.2
Wage rate (per hour) (d)	2.9	1.3	1.7	1.3	2.2	2.1
Labour income share (in %)	78.5	79.6	79.2	77.7	77.8	78.2
<b>Other</b>						
Individual saving share (in % disposable income) (c)	-0.8	-0.4	0.8	0.9	2.2	1.6
Balance current accounts (in % of GDP)	10.2	11.0	10.6	11.1	11.1	10.5
level in % of GDP						
<b>Public sector</b>						
EMU balance	-3.9	-2.4	-2.4	-1.9	-1.7	-1.2
EMU debt (ultimo year)	66.4	67.9	68.2	66.3	65.4	64.1
Collective financial burden	36.0	36.6	37.5	37.5	37.5	37.7
(a) Goods and services, excluding resources and fuels.						
(b) Businesses, excluding health care, mineral mining and the real estate sector.						
(c) Level; disposable family income includes collective saving.						
(d) From this CEP 2016 onwards, CPB will use employment hours instead of labour years as a measure of labour input. This affects the figures on wage rates and employment. On 21 March 2016, the day of publication of the CEP 2016, a (Dutch) background document will be published to provide further explanation on this subject.						

On balance, the increase in employment will just be large enough to absorb the additional labour supply (Figure 4, left-hand side). Unemployment is projected to decline, this year, down to 6.5%, and even further next year, to 6.3%. This decline is slow, compared to previous times of decreasing employment (Figure 4, right-hand side), when the annual decline in unemployment, on average, was between 0.5 and 1.0 percentage points lower. This may be explained by the fact that, currently, there is hardly any increase in employment in the public sector and particularly in health care.

**Figure 4 Employment market rises just enough to absorb the labour supply (left), the decrease in unemployment is slow, compared to earlier decreases (right)**



Source: CPB calculation based on CBS data ([link](#))

### 1.3 Wages, prices and purchasing power

Inflation development (HICP), this year, will be strongly determined by the drop in oil and import prices, thus arriving at 0.3%. For next year, inflation is projected to increase to 1.0%, as oil and import prices are expected to have a positive rather than negative impact. Rent price development, in both years, will have a limited upward effect on inflation of 0.1 percentage points.

Contractual wage development in the market sector this year will be 1.5% and is expected to increase next year to 1.7%, due to a slightly more favourable situation on the labour market and a larger margin for wage increases at companies, because of the increased profits of the last years. These higher contract wages in the market sector, in both years, will be coupled with an incidental wage increase of 0.5%. Contract wage development, incidental wages and social security premiums will lead to a real wage-rate development that is roughly in line with the increase in labour productivity. The labour income share, therefore, will remain rather steady, in both years.

The impact of further decreasing energy prices on inflation will this year hardly lead to lower contract wages, as these wages have already been set at a certain level for nearly half of all employees. The real wage rise of 0.9% will this year give a positive impulse to the purchasing power and improve median static purchasing power by 2.3% (Table 2). The 5-billion-euro package of tax relief, including the increased expenditure on labour deduction, child-related

benefits, income-dependent combination of tax credits, and pensioner deductions below the income level of 36,000 euros, will also have a positive impact on the purchasing power in 2016. Unfavourable effects on purchasing power include the abolition of pensioner deductions in tax box 3, lower pensioner deductions above the income level of 36,000 euros, and an increase in the low IAB tariff (health care premiums) for the elderly and the self-employed. In 2017, there will be a limited increase in median static purchasing power (0.2%). The employed will see an increase in their purchasing power, due to a real wage increase of 0.6%. This group will benefit, for example, from the increase in the expenditure on labour deductions. Low-income households, benefit recipients and pensioners will experience a loss in purchasing power in 2017. Pensions will hardly be indexed, next year. The purchasing power of these groups will be negatively affected by, among other things, the lowering of the maximum general tax deductions, limitations on health care subsidies and rent allowances, and the lowering of the pensioner deductions below the income level of 36,000 euros. Traditionally, the purchasing power situation for the coming year is considered before finishing the budget for next year .

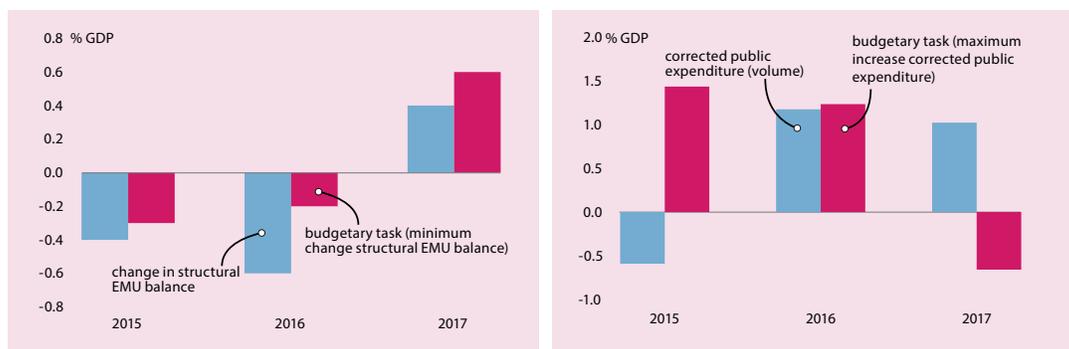
**Table 2 Mutations purchasing power 2016 and 2017**

	2016	2017	
	median purchasing power mutation in % (a)		size in % total (b)
<b>Income level (c)</b>			
< 175% lmw*	1.5	-1.1	36
175% – 350% lmw	2.9	0.3	39
350% – 500% lmw	3.0	0.7	15
> 500% lmw	2.3	0.8	10
<b>Source of income (d)</b>			
Employed (e)	3.4	0.6	63
Unemployment beneficiaries	1.1	-1.0	10
Pensioners	1.1	-1.3	25
<b>Household type</b>			
Two-income households	2.8	0.4	52
Single-person households	1.7	-0.4	42
One-income households	1.7	-0.2	6
<b>Household composition (f)</b>			
With children	3.5	0.7	26
Without children	2.8	0.4	49
<b>All households</b>	<b>2.3</b>	<b>0.2</b>	<b>100</b>
(a) Static purchasing power mutations, excluding incidental income mutations.			
(b) Percentage of the total number of households in 2016.			
(c) Gross income from employment or benefit payments, on household level; gross minimum wage (lmw) in 2016 is around 19,800 euros.			
(d) The order according to source of income is based on the highest source of income on household level, with households in which the main earner or partner has income from profit having been included under the employed. Households with their main source of income from early retirement benefits or student grants were excluded.			
(e) Incidental wage mutations, such as the receipt or loss of bonuses, were not taken into account for the purchasing power of the employed.			
(f) The order according to household composition is based on the presence of children up to the age of 18, and excludes pensioner households.			
*lmw = legal minimum wage			

## 1.4 Government finances

As a result of the continuing moderate economic recovery, the government deficit is projected to decrease, from 1.9% of GDP last year to 1.7% in 2016 and 1.2% in 2017. In 2016, the increased impact of deficit-reducing measures in the Rutte–Asscher Government Agreement will be neutralised by the expansive effect of the 5-billion-euro package of measures and the additional costs of 0.5 billion euros related to asylum seekers. In 2017, these additional costs are expected to be 0.7 billion euros higher than the 2015 level. Based on the population forecast by Statistics Netherlands (CBS), we assumed a total influx (first asylum applications and family reunification) of 85,000 and 70,000 people, for 2016 and 2017, respectively. The continuing recovery of the economy and decrease in unemployment will lead to higher tax revenues and fewer unemployment benefit payments. Lower revenues from natural gas sales, due to lower production levels as well we lower prices, will attenuate the deficit reduction. On the other hand, there is the reduction in the Dutch EU contribution, which will be received retrospectively, as a result of the ratification of the EU’s Own Resources Decision (the way in which the EU budget is financed). This effect will stop in 2017. Nevertheless, due to a moderate development in spending, the deficit will be reduced further in 2017. Real health care expenditure will closely follow GDP volume, whereas social security, education and public safety are clearly running behind. The deficit reduction projected for 2017 is in line with the reduction indicated in the analysis of the Rutte–Asscher Government Agreement.<sup>2</sup>

**Figure 5 Structural balance (left), expenditure rule (right) and the European budgetary task**



Source: CPB adaptation of CBS data ([link](#))

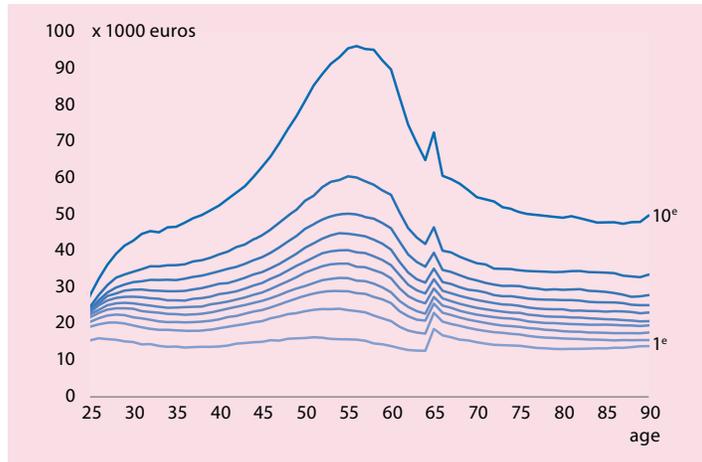
<sup>2</sup> The financial analysis of the Government Agreement showed a reduction in the deficit, between 2016 and 2017, of 0.5 percentage points of GDP. See the report on the actualisation of the Dutch economy up to 2017 (*Actualisatie Nederlandse Economie tot 2017 (verwerking Regeerakkoord)* (in Dutch), CPB Communication 29-11-2012 ([link](#))).

The budgetary task for the structural balance, based on the EU-agreed budgetary regulations, is projected for 2017 to be a required improvement of 0.6% of GDP (Figure 5, left-hand side).<sup>3</sup> The improvement in the structural government deficit, under current policy assumptions, will be 0.4% of GDP. Corrected public spending will exceed maximum growth, based on EU budgetary regulations (Figure 5, right-hand side).

## 2 Analysis

People have to eat every day of their lives, but only earn money over a certain number of years. In order to distribute their consumption more or less evenly over their lifespan, the Dutch amass financial resources in various ways during their productive years, usually up to their retirement. The main methods are: saving money themselves or investing it; paying pension premiums; and, for a large part via mortgage repayments to become debt-free homeowners. In this respect, the government is involved to a large degree, and where pensions are concerned social partners also play an important role. Building pension savings via a pension scheme is even mandatory for the majority of employees. With respect to homeownership, there are strong fiscal incentives to buy, on the one hand via mortgage interest rate tax deductions and, on the other, by limiting the number of years of entitlement to these reductions. These types of government measures are mainly driven by the desire to protect people against their own myopic behaviour and by the positive impact of homeownership on their environment.

**Figure 6** Gross incomes over the life course, per income decile, corrected for the household situation



Source: Redistribution from a life-course perspective, Technical background document of the CPB Policy Brief 2015/6.

<sup>3</sup> The size of the budgetary task depends on the structural balance, the output gap and the government debt of the preceding year. The structural balance projected for 2016 is -1.6% of GDP, under a limited negative output gap (EC method) and a government debt of more than 60% of GDP. This implies a budgetary task of over 0.5% of GDP. See Annex 2, European Commission, 2015, Making the best use of the flexibility within the existing rules of the Stability and Growth Pact, Communication (2015)12. ([link](#)), for which the Commission applied a budgetary task of 0.6% of GDP.

Whether this type of governance will prove to be optimal in practice, is debatable. Many people, particularly those on a high income, spend a substantial part of their income on pension premiums and mortgage payments in their younger years. This timing seems off, in light of the expected increase in people's future income and the costs related to children, which particularly for younger people (say in their thirties and forties) lead to fewer individual consumption possibilities.<sup>4</sup> This shows that borrowing money against future – uncertain – income is difficult.

For each income decile (ordered according to accumulated income over the life course), Figure 6 presents a picture of the combined impact of these factors. It shows that, particularly among people with a high income over their life course, those in their fifties have a higher standardised income (corrected for household size and composition)<sup>5</sup> than people in their thirties and forties.

The costs of homeownership when people are younger put pressure on other household spending. This is demonstrated in Table 3, using data from CBS budget research. The ratio between mortgage payments<sup>6</sup> and disposable household income is high, particularly for relatively young people.<sup>7</sup> For those over the age of 55, the financial burden in relation to their disposable income is considerably lower than for younger people.<sup>8</sup> This is true for all income levels.

**Table 3 Ratio between mortgage payments and disposable income of homeowners, for various age and income groups, in 2013 (in %)**

Income group	1st to 6th decile	7th and 8th decile	9th and 10th decile
<b>Age income earner</b>			
< 35 years	32	27	24
35–44 years	34	27	25
45–54 years	32	21	17
55–64 years	23	17	12
65 years and over	15	8	9

Source: CBS Budget research and CPB calculations

Bringing consumption possibilities forward in time may have an increasing effect on welfare, as the additional value of consumption declines as it becomes more abundant. The question then would be whether such a shift would be possible by changing the way in which the government is currently directing pension build up and homeownership. By offering people a greater freedom of choice about how much they save for their retirement as well as the

<sup>4</sup> This issue is also addressed in a recent Netspar publication. See Netspar, 2016, *De routekaart naar een meer integrale benadering van wonen, zorg en pensioen*, Netspar Occasional paper 01/2016 (in Dutch).

<sup>5</sup> Standardisation of income is a often used method that is used, when measuring the welfare position or living standard, to take the household situation also into account, in addition to income. In this calculation, the total household income is divided by a factor that, also considering impact of scale, shows the reduction in individual consumption possibilities for people in multiple-person households.

<sup>6</sup> Mortgage payments here are defined as the sum of (gross) interest rate payments, repayments, saving premiums and life insurance premiums.

<sup>7</sup> Mortgage financing does offer the possibility to realise a more level housing-consumption pattern over the life course.

<sup>8</sup> The presented ratios concern a cross-section measurement and therefore do not necessarily represent costs over the life courses of individual households.

time within which to do so, this would obviously better suit individual preferences. Moreover, strong forms of governance that try to protect people 'from themselves' would seem less necessary for the higher income brackets, where such measures are the most restrictive. This usually concerns higher educated and better informed people, for whom there is less need for government guidance as they are more capable of considering the consequences of their decisions. The income of these people is far above the minimum level, which means that a certain – conscious or unconscious – reduction in income would have less severe consequences in terms of poverty risks. Thus, the disadvantage of such a prescriptive governance regime could be greater than the advantage of the protection it offers.

What measures, including fiscal ones, could bring about a shift in consumption possibilities from 'old to young'? There are various options, each with its own advantages and disadvantages.

One option is that of changing the pension system. This could involve providing a greater freedom of choice with respect to pension ambitions, whereby the paternalistic element is somewhat toned down. By reducing the mostly compulsory second pension pillar in favour of the third, citizens obtain more freedom to plan their consumption and wealth over the course of their lives without the government imposing limitations on their personal ambitions in this regard. The compulsory part of the pension build up, for example, could be set at a lower level than the current 100,000 euros, or people could be given more freedom for their entire pension build up by implementing 'yes/no, unless' regulations. In addition, the pension benefit payment side could also be made more flexible; for instance, by creating the possibility for lump sum payments, as is currently in effect in some countries, such as in Denmark. These financial means can then be applied to mortgage or debt repayments. A final aspect is the pension premium itself. In the current situation, most pension funds have a flat rate premium and similar build-up of rights, even though the return on the contributions by young participants is more over their life course, due to the longer timespan they cover. If the build-up would be kept the same over the life course, premiums could be lower at a younger age. An important downside of this approach would be the even greater increase in wage costs for older employees<sup>9</sup>, a group of people that is already more at risk of (prolonged) unemployment. Another effect would be that moving the premium payment obligation to a later point in the life course would also cause a shift in the premium costs from lower to higher income groups, which would therefore have a levelling effect. Whether this would be an advantage or a disadvantage would depend on the preferences concerning the distribution of income.

A second option is the fiscal approach to homeownership as a capital component. Currently, financial capital is taxed in Box 3 of the Dutch tax form, while privately owned homes belong in Box 1. The interest paid on mortgages can be deducted against a maximum of 50.5% (in 2016), and a tax is levied on the notional rental value of the privately owned home. Homeowners without a mortgage are not entitled to such deductions, but they are also not

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<sup>9</sup> Employers pay a large share of the pension premium.

taxed over the notional rental value of their property. The 'income' from this asset remains untaxed. The chances of ending up in the second category increase over the life course. Moreover, people tend to move to more expensive homes as they grow older. Shifting the privately owned home and mortgage to Box 3, with a positive balance of the WOZ value (Dutch average property value for tax purposes) and the mortgage included in the tax base, effectively means a shift of taxation towards a later time in the life course<sup>10</sup>, and definitely in case the revenue of this manoeuvre is applied to a general reduction in the financial burden. This measure can also be viewed from another perspective; the various forms of capital would then be treated as equally as possible, there would be no preferential treatment of foreign capital, the distortion between buying and renting a home would be reduced, because the subsidy on homeownership would be abolished.<sup>11</sup> In this way, the measure would have a levelling effect.

A third option specifically addresses the conditions under which people are entitled to mortgage interest rate deductions. The required amount in mortgage repayments could be limited to 50% (not changing the timespan over which the interest rate is tax deductible, thus not increasing the size of the fiscal subsidy). In line with modern behavioural-economics approaches, the 'Blok mortgage' which is currently a hardly used deviation would thus be turned into the standard.<sup>12</sup> An alternative could be to make the restriction only applicable to younger age groups, with a catch-up obligation later on during the life course. Such measures would reduce the financial burden for young homeowners. For example, in the case of a 'level payment' mortgage of 200,000 euros, a halving of the compulsory repayments in the first ten years would equal an annual net saving of over 2000 euros. To prevent this option from mainly having an increasing effect on house prices, the existing rules about the size of the mortgage (the maximum for the LTV and LTI ratios) must be maintained. On the other hand, the consumptive options will be reduced later on during the life course. From an implementation perspective, this option is rather complicated for the tax department. An additional disadvantage of the limited repayment obligation is the greater risk for young households of ending up with an underwater mortgage, sometimes for longer periods of time.

A fourth option is that of coupling pensions to privately owned homes. In this way, a reduction in pension build up could be realised while the mortgage is being repaid. Such a policy direction would lead to 'made to measure' pensions, with homeowners as a rule building up lower pension capital than tenants. Pension build up, naturally, would then be adjusted accordingly. If pension premiums would be lowered by a third, this for example could lead to an increase of over 1000 euros in purchasing power for employees with a gross

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<sup>10</sup> For the average homeowner over the age of 55 who has fully repaid his mortgage, who enjoys tax exemption over his homeownership in Box 1 thanks to the bill by Hillen, this measure for 2016 would lead to an increase in financial burden of around 3500 euros. The average value of the privately owned home, for this age group, is around 300,000 euros, which yields this amount in additional taxation under a capital gains taxation of 1.2%.

<sup>11</sup> See CPB Policy Brief 2015/16, on a more uniform taxation of capital income (Een meer uniforme belasting van kapitaalinkomen [in Dutch]).

<sup>12</sup> The so-called Blok mortgage gives the possibility of taking out an additional mortgage for which there is no entitlement to tax deductions. To date, this option is little used, perhaps because in addition to the fiscal condition there may also be a certain behavioural-economic inertia to deviate from the more ready-made mortgage options.

annual income of 50,000 euros.<sup>13</sup> A side effect would be a slight levelling-off, because this would involve a reduction in subsidies on pension saving<sup>14</sup>, something that benefits particularly the higher income groups. Disadvantage would be that it reduces diversification of wealth and thus increases the risks. As long as the pension system is based on an average premium, with young and old having similar entitlements for the same amount contributed despite the differences in investment horizons, such a measure will undermine the pension system.

The government has a large amount of influence on how we are able to spend our income over the life course. The policy concerned has been implemented from sincere, paternalistic motives; people are myopic and certain issues are simply too complicated for non-specialists to consider. However, the government also does not operate from a 'grand design'. Policies are being added to already existing other policies and cohesion between them is sometimes lost. Current policies on pensions and homeownership hinder the distribution of consumption over the life course. This also causes vulnerability for the Netherlands as a whole. On the one hand, there are large amounts in pension capital exposed to financial market risks, while, on the other, people have large debts in the form of mortgages, which is not a carefree situation, by any means<sup>15</sup>. Changing these arrangements is complex; it requires making fundamental choices about both pension and tax systems, and in addition is bound by the possibilities and impossibilities of how these systems can be executed. Perhaps not a subject that could be solved on a rainy afternoon, but a start could be made in a new government agreement.

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<sup>13</sup> This calculation assumes that the advantage of the lower premium for the employer is counteracted by an increase in gross wages. Thus, the wage costs will remain the same.

<sup>14</sup> This subsidy is the result of the fact that the tariff for the tax deduction of the pension premium is higher than the tariff at which the pension benefits are taxed after retirement.

<sup>15</sup> See Lukkezen, J. and A. Elbourne, 2015, *De Nederlandse Consumptie, Goede tijden, slechte tijden* [Dutch consumption; good times, bad times (in Dutch)], CPB Policy Brief 2015/3.

## Appendix: main differences with the December projections 2015

The most important adjustments since the December projections 2015:

- Adjustments to the international volume in 2016 and 2017 are downwards. The primary factor – in addition to the availability of data on the third and fourth quarters of 2015 – is the weaker economic growth in the emerging economies. Global GDP growth has been adjusted downwards for 2015 and 2016, by a respective 0.3 and 0.6 percentage points, to 2.8% and 2.9%.
- For the eurozone, GDP growth is now projected at 1.5% for 2015 (unchanged) and 1.6% (-0.2 percentage points) for this year. The increase in relevant world trade was 3.6% in 2015 (+0.3 percentage points) and will be 3.8% (-0.5 percentage points) in 2016.
- GDP in 2016 will turn out 0.3% lower. This is particularly due to a downward adjustment of consumption in the fourth quarter of 2015, based on realisations; on balance, this will have only a limited impact. The positive adjustment of government consumption levels and the downward adjustment to investments (mainly stocks) more or less balance out.
- Unemployment in 2016 is projected, on balance, as being 0.2 percentage points lower, particularly due to the downward adjustment to the labour supply, based on realisations.
- Inflation (HICP) has been adjusted downwards by 0.6 percentage points for 2016, due to the lower oil and import prices and lower inflation in January 2016.
- The government deficit in 2015, on the basis of preliminary data, is now estimated at 1.9% of GDP, which is 0.3% below that in the December projections 2015. This is the result of higher tax revenues, despite the lower revenue from natural gas sales.
- The government deficit for 2016 is now projected at 1.7% of GDP, which is 0.1% below that in the December projections 2015. This is mainly the delayed impact of the higher tax revenues in the previous year. The downward adjustment to the natural gas price reduces the amount in gas revenues. The costs related to asylum seekers have been adjusted upwards, in line with the increase in influx numbers conform the CBS' population forecast.
- Median static purchasing power will increase by 0.5 percentage points in 2016, due to a downward adjustment of the cpi by 0.5 percentage points. Wage levels in the market sector have also been adjusted downwards (0.1 percentage point).



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