# Are there fault lines in the Netherland's pension provision?

De Koning, Kees

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## By

## Drs Kees De Koning

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## Introduction

According to the latest figures from the OECD[1]: from all OECD countries Denmark came out on top with an accumulated pension savings representing 199.0% of the Danish GDP. The Netherlands came second with an accumulated pension fund savings of 171% of GDP.

Size matters, especially the changes in size that have taken place over time. For instance in 2007, the Assets Under Management (AUM) of all Dutch pension funds represented just 108.8% of the 2007 Dutch GDP level. Since then, Dutch pension fund assets have grown much faster than GDP levels. Size also matters for the Dutch government debt levels. In 1995 it reached its highest level of the last 24 years at 73.1% of GDP. In 2009 the level stood at 56.8% and by 2018 the level was 52.4%. Over time, Dutch Finance Ministers have managed to reduce the borrowing levels; in other words taxes were used to repay outstanding government debt levels relative to GDP levels..

The 52.4% of GDP represents €406 billion in Dutch government debt for 2018. Compare this to the total savings in Dutch pension funds in 2019 of € 1428 billion and it is clear that all pension funds together could potentially only invest 28.4% of their portfolio in Dutch government bonds. Of course, this is unrealistic given that some private domestic and foreign investors might wish to buy some Dutch government bonds as well. The ECB has been a buyer of bank bonds since 2015. Its Quantitative Easing program of €2.6 trillion is spread over all Eurozone countries on basis of each country's relative share in the Eurozone GDP. With the Dutch share of 4.8% of the Eurozone GDP, such purchases amounted to €125 billion. This leaves Dutch pension funds with a much-reduced opportunity to buy Dutch bank risks.

The flaws in the Dutch pension system are linked with the government's assessment of the adequacy of providing for future pension payouts. The law states that such assessment should be made on basis of the Ultimate Forward Rate, which in 2015 was reduced to 3.3%. Three factors are currently in play: negative interest rates on government bonds; diminished Dutch bank risks on offer due to ECB's quantitative easing and thirdly the expected slow down in economic growth, which is already manifesting itself in the sharp drop of share prices on the European stock markets.

[1] http://www.oecd.org/daf/fin/private-pensions/Pension-Funds-in-Figures-2019.pdf

## Chapter 1: The macro economic overview of the Dutch pension market over the period 2007-2019

The following variables are set out below: Year, Pension Assets Under Management (all pension funds), Netherlands GDP, Dutch CPI annual level and yield on 10 year Dutch State bonds.

| Year | AUM Euro Billions | GDP Euro Billions | Annual CPI change % | Yield 10 year Dutch Treasuries % |
|---|---|---|---|---|
| 2007 | 666.7 | 613 | 1.87 | 4.27 |
| 2008 | 655.5 | 639 | 1.95 | 3.67 |
| 2009 | 554.8 | 617 | 1.11 | 3.45 |
| 2010 | 699.9 | 632 | 1.93 | 3.12 |
| 2011 | 743.7 | 643 | 2.42 | 2.44 |
| 2012 | 843.6 | 655 | 2.89 | 1.58 |
| 2013 | 943.5 | 659 | 1.65 | 2.15 |
| 2014 | 993.9 | 672 | 0.70 | 0.79 |
| 2015 | 1249.1 | 690 | 0.69 | 0.74 |
| 2016 | 1199.2 | 708 | 0.98 | 0.44 |
| 2017 | 1284.2 | 738 | 1.25 | 0.46 |
| 2018 | 1329.8 | 774 | 1.96 | 0.41 |
| 2019 | 1428.3 | | 2.8 (August) | -0.59 (August 15) |

### 1.1 Interpretation of the data

Above statistics show that the AUM of the combined Dutch pension sector have grown much more rapidly than the GDP levels; to be precise the AUM practically doubled between 2007 and 2018. The Dutch GDP grew by 26.3% over the same period.

Another factor to be taken into account is the increases in the level of the Dutch population, which currently stands at 17.106.426 individuals on 29 September 2019. In 1992 the population growth rate reached an annual level of 0.67%. Ever since 1992, the annual growth rate has steadily declined. It was 0.4% in 2007 and 0.22% in 2018. Linked with the slowing growth in population, the median age is going up. In 2005 the median age was 39 and by 2020 it is expected to be 43.3 years.

This paper will not discuss average life expectancy levels as this a job for professional actuaries.

### 1.2 The links between inflation levels and the yield on Dutch Treasuries

2019 is a historic year in terms of the yield on Dutch government bonds. The OECD statistics[2] about the yield over the 10-year Dutch government bonds show that since 1960, such yields have never been in negative territory except in 2019.

It is not that inflation levels are slowing down, rather the opposite, but yields on 10-year Dutch government bonds have fallen below 0 %.

It may be interesting to quote a 17th century Dutch experience[3]:

"The positive side of a well-managed public debt, like the Dutch one, is that it expands the purchasing power of the state in a timely fashion, without putting undue burdens on the tax payer. However, there are prices to pay. One of those prices is an appreciable redistributive effect, when via the debt service money is channelled from a large proportion of the population (the tax payers) to a much smaller number of bondholders. In the beginning (thanks also to the forced character of the lending) this effect was limited by the broad distribution of debt-holders across the population. In the course of the 17th century, however, bondholding became more concentrated. One of the reasons for this was that new bonds were often financed by reinvesting retained interest by existing

[2] https://fred.stlouisfed.org/series/IRLTLT01NLM156N: source OECD, Economic Indicators

[3] https://en.wikipedia.org/wiki/Financial_history_of_the_Dutch_Republic#Public_finance

bondholders. This effect increased commensurately with the increase of the debt and the debt service. It was reinforced by the fact that bondholders were thrifty people.

In the course of the final third of the 17th century, and especially of the 18th century, this concentration of the public debt in the hands of a few gave rise to the emergence of a *rentier class* that amassed an important proportion of total wealth in the Republic, thanks to this redistributive effect, and despite the often confiscatory levies on wealth of the 18th century described above. This development went hand in hand with the development of the public debt itself after 1672. During the second half of the Golden Age (especially the years 1650–1665) the borrowing requirements of commerce and the public sector fell short of the amount of savings supplied by the private sector. This may explain the boom in real estate of those years that sometimes acquired a "bubble" character. However, after the beginning of the Franco-Dutch War of 1672 these savings were rechanneled to the public sector (explaining the collapse of the housing bubble at the same time). Nevertheless, the holders of this rapidly increasing public debt were still awash in cash, which explains the low interest rates in the years up to 1689. This availability of funds also helped finance the great expansion of the VOC- the Dutch East Indies Company- (and of its debt) in these years."

Returning to current days, the class of a small group of 17th century rentiers has been replaced by large pension fund organisations, representing many, many individuals who are saving or have saved for a pension pay out. Nearly all of these savers rely on such current or future income to enjoy a financially stable retirement period.

The current negative yields on Dutch (and German) government bonds -a first for at least the last 60 years[4]- can be compared to a tax on savings. Investors receive less money back than they put into the bond issue in. It is not a tax on the rich in society, which would be redistribution type of tax. It is a tax on ordinary people, who have put and more importantly were encouraged by government rules to put their trust in pension funds as the collective vehicles to manage their savings.

This same government –especially in the views of the Pension Regulator- claims that paying more tax on savings should have been foreseen well over a decade ago. Pension funds should have taken steps to prevent the effects of such tax payments. The same Regulator now recommends substantial discounts on future pay-outs.

[4] https://fred.stlouisfed.org/series/IRLTLT01NLM156N: source OECD, Economic Indicators

The effect of the current high inflation levels, high under Dutch standards at a level of 2.8%, will bring in higher tax receipts. Higher salaries and higher employment levels as well as higher price levels for most goods and services will see the tax intake go up.

Perhaps the time has come to consider measures that can help the Dutch pension funds to cope with negative interest rates and the lack of alternatives to holding a substantial share of their portfolios in Dutch bank bonds.

## 2. An alternative option

Early in May this year, the Dutch Minister for Social Affairs and Employment, Mr Koolmees, wrote a letter to the Dutch Parliament about the agreed changes to the Dutch Pension Contract. Employer federations, trade unions and government representatives all accepted these changes. In an English summary in an IPE article most of these changes[5] are described..

However a major stumbling block was not dealt with in the Minister's letter: "What to do about the negative interest rates on Dutch government bonds and what are the implications for pension funds in their valuation of assets."

Opinions differ, but making a choice becomes easier if one considers that a tax on savings reflects a transfer of income from the bondholders to the state. If such savers are savers in pension funds, who can -as yet- not withdraw any of their funds from these pension funds, then the only reasonable option is that the government reimburses the pension funds for a loss of earnings. If, at the same time, CPI inflation levels are running above 2%, then the increased tax receipts out of incomes allow for an additional compensation level for pension funds.

The main rationale for setting up a system to compensate pension funds for loss of earnings is that high inflation levels (above 2% per annum) and interest rates on government bonds below 0% are economic distortions caused by government policies (including ECB decisions). As this matter involves a special allocation of tax receipts, such allocation needs the support of The Houses of Parliament in the Netherlands. It is customary to obtain the advice of the Social Economic Council (SER) before the matter is raised in Parliament.

[5] https://www.ipe.com/countries/netherlands/dutch-social-partners-and-government-reach-agreement-on-retirement-age/

## 3. A logical conclusion

A tax on collective savings, a diminished availability of bank bonds to the extent of €125 billion, an increased negative deposit rate for surplus bank funds (from -0.4% to -0.5%), and a sharp drop in share prices all point to the need for government action.

From a macro-economic point of view, a fiscal injection into the pension sector could be the remedy to keep up demand levels at a time of economic uncertainty.

Three steps could be made in the following order:

Step 1: The macro approach

The Dutch government could on the advice of the Social and Economic Council (SER) make a proposal to parliament to set aside an amount to achieve the macro-economic objective of retaining a stable pension sector. Each year the amount could be reconsidered.

Step 2: The micro approach

The Pension Regulator could set up and Chair a Steering Committee made up of representatives of the various groups of pension funds (Company, Industry and Civil Servants) to decide how to distribute the government allocation to pension funds.

Step 3: The macro and micro approach combined

It could be suggested that a special purpose vehicle might be created: A National Pension Bank (NPB). The NPB could be set up for the purpose of facilitating the transfer of funds between the government and the pension funds. Owners would be all pension funds pro rata their Assets under Management, The Chairman could be a Representative of the Regulator. The NPB could issue 0% bonds to the sole buyer: the Dutch government. The advantage is that as soon as Parliament agrees to a certain amount then such amount is already available with the NPB. Furthermore the distribution ratio could already have been agreed by the Steering Committee. Only after all those agreements have been made, the Government could take the tax provision for the allocation to pension funds.

Drs Kees De Koning

Chorleywood, U.K.

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