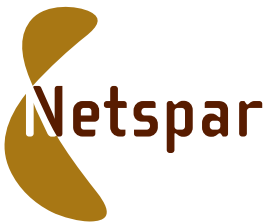


# Netspar News

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### Photography

Maurice Bastings, Maastricht (p 23, 24)

Clickshots Evenementenfotografie,  
Montfoort (p 20, 21)

Dolph Cantrijn, Tilburg (p 14, 15, 16)

Dirk Hol, Den Haag (cover & p 5, 6, 7, 8, 10)

Ton Toemen (p 26, 27)

### Cartoon

Hans van den Tillaart

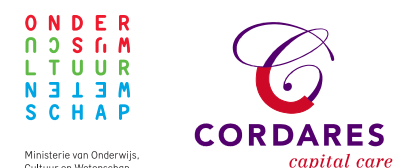
### Graphic Design

Laverbe, Nijmegen (Concept)  
Sander Neijns, Tilburg

ISSN 1574-8790

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## Netspar Partners



## Netspar News

is published by Netspar, Network for Studies on Pensions,  
Aging and Retirement

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# Netspar's First Year



Netspar's first annual report

By Theo Nijman

## Exchange of information

During our first year, the exchange of information with our partners was accomplished in a variety of ways, including workshops, pension days and conferences— some of which were organized in cooperation with or hosted by Netspar's academic and non-academic partners. These events brought together some of the leading researchers and practitioners in the field of pensions and aging.

## Fundamental research

Netspar has also established three research programs aimed at examining the micro-, meso- and macro aspects of pensions and the aging of society. The last issue of *Netspar News* describes the main focused-research projects that were initiated in order to create more focus and mass. To improve the data infrastructure that is required for analyzing individual behavior in relation to retirement and retirement provisions, Netspar has spearheaded cooperation between Statistics Netherlands (CBS) and Netspar's partners. In this issue you will find an article about the first pilot project, which started up in September 2005.

## Education

Netspar had another reason for celebration in April. In April 2006 the last step in the official accreditation process was made: the Ministry of Education, Culture and Science fully accredited Netspar's new master's MSc program on the economics and finance of aging, designed to equip students to tackle the complex issues surrounding pensions, aging and retirement.

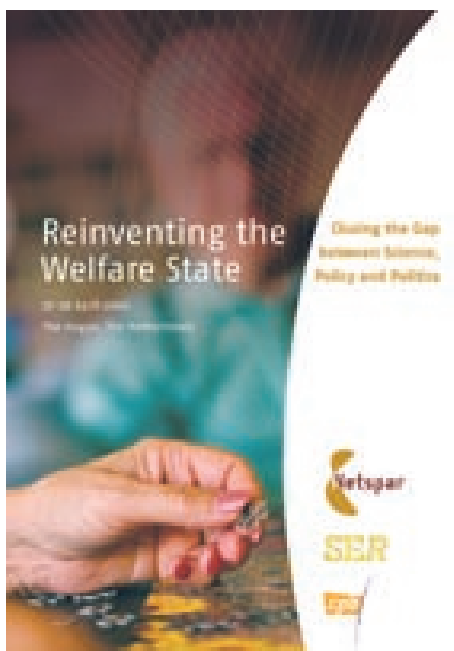
Public recognition was also achieved in 2005. The Innovation Platform recognized Netspar as an important catalyst for innovation (in the "emerging key area" of pensions and social insurance). Moreover, the Minister of Education, Culture and Science selected Netspar as a Societal Top Institute (Maatschappelijk Topinstituut, MTI, in Dutch).

This issue of *Netspar News* features a number of the first year's activities. An extensive survey of Netspar's activities, as well as the new challenges we are facing, is given in our first annual report, which was recently published.

I hope that you enjoy reading this issue as much as I have enjoyed participating in Netspar's first year of activities.

# Netspar Annual Conference Tackles Tough Topics

Countries throughout Europe face increasingly complex issues surrounding the mandate to provide cradle-to-grave protection for their citizens. People have come to consider this protection a basic human right. But with declining birth rates and increasing longevity in most populations, governments are hard-pressed to continue to deliver on the implied promise of a basic standard of living, high quality, affordable healthcare, and retirement benefits for all their citizens.



By Margaret Kavanagh

### The world's best and brightest

At its first Annual Conference in the Hague on 27–28 April 2006, Netspar, in cooperation with CPB Netherlands Bureau for Economic Policy Analysis, and the Netherlands Social and Economic Council (SER), assembled leading economists, both national and international, and key policymakers to discuss the future of the welfare state. The theme of the two-day event was “Reinventing the Welfare State: Closing the Gap between Science, Policy and Politics”. Preeminent economists, including Nobel Laureate (Economics, 2000) James Heckman, of the University of Chicago, Assar Lindbeck, of the Institute of International Economic Studies at the University of Stockholm, Lans Bovenberg, of Netspar/Tilburg University, Tony Atkinson, of Nuffield College, Oxford, and the Paris School of Economics, among many other major names in the field, presented papers and exchanged views on the primary issues that need to be addressed if Europe, and the Netherlands, in particular, hopes to resolve these fundamental concerns.

Two primary issues dominated the proceedings: 1) How serious are the challenges faced by the social model as a result of aging, globalization, migration, increasing diversity and heterogeneity, and

technological changes? and 2) How should European welfare systems be designed in the future?

### Laying the groundwork

The first day and a half focused primarily on science, and covered migration and globalization; skill formation; aging, retirement and pensions; and comparing welfare states. The afternoon session of day two was devoted to policy matters, with an examination of the future of the welfare state in the Netherlands, and the political economy of the welfare state. The latter topic brought together two of the Netherlands' leading politicians: Wouter Bos, M.P. and leader of the Dutch Labor Party, and Aart-Jan de Geus, the Dutch Minister of Social Affairs and Employment. In addition, Kees Goudswaard, member of the Social Economic Council (SER), the main advisory body to the Dutch government on social and economic policy, presented his views and those of the SER on welfare state policies.

### Spirited panel discussion

A lively, sometimes passionate, panel discussion on the future of the welfare state rounded out the day's events. Panel members included Tito Boeri, Bocconi University, Milan; Tony Atkinson, Oxford University; Torben Andersen, Chairman of





the Danish Welfare Commission; Peter Sørensen, University of Copenhagen; James Heckman, University of Chicago; Gösta Esping-Andersen, Universitat Pompeu Fabra, Barcelona; and Assar Lindbeck, University of Stockholm.

#### Media-worthy event

The significance of the policy implications of these proceedings was evidenced by the extensive media coverage afforded the Friday afternoon session. It was standing room only when the politicians and policymakers took the floor to offer their views on the future of the welfare state. The first speaker in the policy session was Kees Goudswaard, of SER.

In his address, Goudswaard outlined some of SER's recommendations that have been implemented by the current government, including reforms in disability and unemployment compensation and the national health insurance system. He emphasized the key role played by the social partners in conjunction with the government, with a view toward a more balanced distribution of responsibility and accountability, as well as the rewards that result.

#### Two-pillar model

The SER supports a proactive approach to ensure future economic growth through a

two-pillar model: the participation pillar and the traditional pillar. The first builds on existing facilities for education, training, childcare, labor market participation and reintegration. If the first pillar is developed effectively and efficiently, virtually every citizen can become an active participant in the knowledge economy. In addition, the Netherlands needs to promote a more entrepreneurial culture, which will serve to create new opportunities for labor market participation by women and others who have historically been excluded. The traditional pillar would be reserved for those who are physically or mentally unable to participate in the labor market, with the understanding that society has an obligation to support and protect those who are unable to support themselves.

#### Defending the Dutch 'consultation' model

Dutch Minister of Social Affairs and Employment Aart-Jan de Geus used a soccer analogy to outline his views on the Dutch welfare state. In his address, De Geus compared the American model with the Scandinavian model. While expressing admiration for the entrepreneurial, risk-taking spirit in the US, De Geus assailed the system for not paying enough attention to the needs of the weakest members of society. In discussing the Scandinavian system, he questioned the basic

Nobel Prize winner James Heckman: "What bothers me the most is the inequality of opportunity."

assumptions about the Scandinavian countries' economies, pointing out that the Dutch economy has fared better in most of the leading indicators than any of the Scandinavian economies. He made a pitch for the often maligned "polder model" – the Dutch tradition of consultation and compromise – suggesting that this model has made possible recent reforms, which have seen dramatic declines in the number of workers on long-term disability and early retirement. De Geus cited a European Commission report commending the Dutch system and the reforms that have resulted from it.

#### Investing in human capital

De Geus suggests that more must be done, particularly with regard to investments in human capital/skills training for those who are currently unable to participate fully in the labor market. He emphasized the need for open borders within the European Union as a vehicle for creating new opportunities for workers as well as entrepreneurs. De Geus criticized the risk-aversion of the younger generation, citing the long-held Dutch tradition of entrepreneurship and risk-taking. He called for sweeping reforms



Lunch at the  
SER balcony

in education, including mandatory English-language instruction in all secondary level education, as well as raising the compulsory education age from 16 to 18 for those who have not completed their education. He suggested the implementation of tax- and other financial incentives for continuing education.

#### Labor Party weighs in

Labor Party leader Wouter Bos picked up on a theme he introduced at a Netspar Pension Workshop in 2005: the precarious position of the Dutch welfare state somewhere in between the Anglo-Saxon and Scandinavian models, and not doing very well in either case. He had suggested that the Netherlands would be best served by modeling itself on the Scandinavian system. At the Netspar Annual Conference he reiterated his contention that the Scandinavian model is the best option for the Netherlands, explaining in some detail why he continues to support this view.

#### Broad public sector offers social cohesion

Bos contends that in this era of uncertainty and insecurity, a broad public sector, such as that found in the Scandinavian system, offers the best opportunity for social cohesion and equal protection for all citizens. This feeling of security will engender public trust, which in turn will

encourage people to take the kind of risks that will help ensure economic growth across the board. It is his belief that the composition of public expenditure is more relevant to the sustainability of our welfare state than the amount of public expenditure. Or, as he says, "Size doesn't matter." He criticizes the current government for pandering to voters with tax cuts, which inevitably result in inadequate spending in crucial areas, such as education and research and development, while overspending in the form of tax deductions on pension savings and mortgage interest, which he views as detrimental to economic growth.

#### Difficult choices

Bos cited a recent CPB Netherlands Bureau for Economic Policy Analysis report that investigated the costs of aging. The report concluded that in order to keep public finances sustainable, some difficult choices must be made. More people need to enter the labor force or those who are working need to work longer; tax deductions on housing and pension savings must be reduced; the retirement age must be raised; and taxes need to be raised or expenditures must be reduced.

Bos suggests three essential policy shifts with respect to public expenditure: 1) a shift from consumption to investment, with less

emphasis on unconditional income transfers and greater emphasis on investment in primary education and childcare; 2) a shift from supporting middle-age men to supporting young children and their mothers; and 3) a shift from protecting jobs to protecting people. These policy shifts will affect the income distribution, and Bos concedes that the challenge will be to improve the efficiency of the public sector while ensuring a more equitable income distribution.

#### Efficiency and equity

In his concluding remarks, Bos outlined specific policy proposals that would pass both the efficiency and equity test, including the following: a major drive toward higher labor market participation; increased public investment in childcare facilities; an end to "perverse solidarity," in which low-income earners effectively subsidize the benefits attained by high-income earners; working longer—both raising the number of hours worked by part-timers and raising the retirement age; and finally, relaxing the current laws that protect workers from dismissal. This is one that would need to be considered very carefully in order to avoid creating anxiety among workers about their job security.

This important two-day event may have raised as many questions as it answered, but at least participants seemed to feel that the right questions are finally being asked, and Netspar has provided the ideal forum for bringing together the people who are best-equipped to help close the gap between science, policy and politics.

# Jewels in the Crown

## Assar Lindbeck and James Heckman

Every profession has its stars and its superstars. Those people who possess that extra flair — the ones against whom others measure their own achievements; the luminaries who by their very presence elevate the proceedings to a higher level of clarity and class. Netspar seems to have a knack for attracting such icons, and the organization's first Annual Conference, held on 27–28 April in The Hague, was no exception. The entire lineup of speakers at this milestone event was a veritable international 'who's who' of the best and brightest in the field of economics. The conference theme was "Reinventing the Welfare State", a topic with which policymakers across the globe have been struggling, as economic constraints and aging populations continue to pose challenges for which there are no easy solutions.

Assar Lindbeck: "There is no such thing as a Scandinavian Model."



### By Margaret Kavanagh

Two of the truly outstanding scholars in the field were on hand at the conference, presenting papers as well as serving as discussants during the lively exchange of views among the entire roster of speakers in the policy debate that closed out the two-day event.

#### Not resting on his laurels

Assar Lindbeck is the Professor of International Economics at the Institute of International Economic Studies at the University of Stockholm. His list of achievements and contributions to the field of Economics could fill many volumes, and he made it clear in an interview during the Netspar Annual Conference that he still has much more to offer and intends to continue doing so for a very long time. At an age when many people would prefer to sit back and rest on their laurels, Professor Lindbeck said he chose to go on working after reaching the official retirement age. "It was my choice," he said. "It's what I enjoy doing, and I think I still have something to offer."

#### Scandinavian Model?

##### What Scandinavian Model?

When asked to comment on the call by the Netherlands' Labor Party leader, Wouter Bos, for the "Scandinavianization" of the Dutch

welfare system, at last year's Netspar Pension Workshop, Lindbeck replied: "I have no idea what people mean when they refer to the 'Scandinavian Model'. There are four Nordic countries, each with its own distinct system. There is no such thing as a Scandinavian Model. But what these four countries do have in common is that they have all made an effort to facilitate the participation of women in the labor force." He said that this orientation toward childcare and elder-care, which enables more women to fully participate in the labor force, is unique among the Scandinavian countries and is worth consideration by other countries.

#### Swedish economy struggling

The economy of Sweden, like all of the Scandinavian countries, is based on free trade and is working toward liberalizing its system. "If anything, Scandinavia is moving toward a more Anglo-Saxon system, rather than the other way around!" As for the idealization of Scandinavia, Lindbeck shook his head and smiled. "This idyllic picture of Sweden is completely false. We're suffering from the same economic problems that every other country faces. In fact, in some respects, it's much worse. Unemployment hovers around 7%, and about 25% of the population is benefit-dependent. The only reason our growth figures look so good is

because we were in such bad shape to begin with! Of course our economies have had tremendous growth in recent years, but that's because we were in such a deep depression." When reminded of the old saying: "There are lies, damned lies, and statistics," Lindbeck agreed. "Choose your year and you can make any country a hero!"

#### Europe's insider/outsider model

Assar Lindbeck is probably best known for his insider/outsider theory of economics, in which "insiders" do everything they can to keep the "outsiders" out. He suggests that Europe is increasingly adhering to that model, ensuring that the rich get richer and the poor get poorer. His research also examines changes in social norms, including the stigmatization of benefit dependency. Once it becomes socially acceptable to become dependent on government benefits, it loses its stigma and more people are tempted to follow suit. "If I see my neighbor retire early with a disability benefit, I might think: 'Hey, maybe I'll do that too.' There is no longer any shame associated with taking a government handout."

#### Left brain/Right brain

Throughout a career that has spanned nearly half a century, Lindbeck has contributed immeasurably to the field of



James Heckman: "Early childhood programs are the best bet for turning things around."

economics. He considers his greatest contribution to be the study of monetary analysis and the changes in fiscal policy in various periods over time. He is currently working on a study of China, examining the relationship between economic reforms and social development in that vast emerging economy. But he is by no means limited to left-brain pursuits. Assar Lindbeck is also an accomplished musician and artist, whose highly introspective paintings have been exhibited several times in Stockholm, with another exhibition scheduled this year in Washington, DC.

#### James Heckman

A Nobel Laureate with disarming modesty, James Heckman has received just about every economics award imaginable, including the Nobel Prize for economics, which he won in 2000, and the Jacob Mincer Award for Lifetime Achievement in labor economics in 2005. He is currently the Henry Schultz Distinguished Service Professor of Economics at the University of Chicago, and Director of the Economics Research Center and the Center for Social Program Evaluation. Heckman is affiliated with universities in China, Ireland and the UK, and is a prolific researcher and writer, with over 200 articles and numerous books focusing on human development and lifecycle skill formation.

#### Damaging effects of racial inequality

Heckman has devoted much of his professional life to examining the effects of racial inequality on economic opportunity in the United States. As a white man from the northern US, Heckman's groundbreaking work in the 1970s was highly controversial, and remains so, to some extent. Using the textile industry as the backdrop, he argued that Civil Rights legislation rather than market forces led to significant changes in segregation and discrimination. His work led him to his current interest: the effects of intervention in early childhood on the achievement gap between blacks and whites in America.

In an informal interview during the Netspar Annual Conference, Heckman talked about the role of personal responsibility in economic opportunity. His goal is to integrate studies of early childhood into a common economic framework for policy analysis. He argues that it is essential to provide disadvantaged children with the proper environment to foster both cognitive and non-cognitive skills in order to reverse the trend toward the growth of an underclass with little or no chance for economic success. By targeting economically disadvantaged children at an early age, the return on investment in human capital will be the highest.

#### Descending the ivory tower

Heckman is at his best when examining "real-life" issues. "Academic life has the risk of keeping people isolated and protected from reality," he said. When asked what his most important contribution to economics has been, he said: "I hope I'm still making it. Although the Nobel Prize was for my work with econometrics, the work I'm doing now enables me to go outside the normal range of topics. Maybe I'm indulging myself in my old age, but I think I have a better understanding of things now, and I feel I'm doing my best work."

He continued: "You can't separate economics from sociology or psychology or even biology. They all play a role in how people evolve and how societies respond to the changing needs of the population."

When asked if he is optimistic about the prospects of closing the gap between science and politics, Heckman was candid: "I'm not very optimistic about individual politicians, but we've already seen in the United States with welfare reform that people who had been dependent on benefits are now working and have restored their sense of dignity. So it's possible— but it's never easy. Education plays a key role, and early childhood programs are the best bet for turning things around."

#### Europe's cultural divide

Professor Heckman travels extensively in his work. When asked whether the problems the US has experienced with the racial divide are finding their way to European countries (which are becoming increasingly more heterogeneous), he replied:

"Absolutely. If anything, the problem is even more intractable here because there are also language and cultural issues to contend with. Early childhood intervention, for example, is difficult in some Muslim communities because the parents are not very receptive to some white, middle-class Dutch person telling them how to raise their children. So if these programs are to succeed, they will have to be very careful to be culturally sensitive."

He said, "You know, the Dutch used to be very disdainful of the US because of our racial problems, but now the situation is reversed. That's not to say that we've completely solved our problems in the US, but the Dutch are only now realizing how



# Reinventing the Dutch Welfare State

difficult these problems can be. In Switzerland, they've never had these problems because immigrants are not allowed to live in isolated enclaves and are required to learn the language. So there is a sort of assimilation by design."

### Satisfaction of achievement

Heckman is quick to point out that "I'm not some crusading zealot. But what bothers me the most is the inequality of opportunity. Overcoming poverty can be very satisfying. Some of the great works of art and literature resulted from the artists' struggle against adversity. Doing a good job – no matter how menial – can give a person a sense of achievement. No one here today mentioned the satisfaction of achievement, which can be a great motivator. We need to find ways to include everyone in the process – to encourage participation and reward people for their efforts. That's the best means of closing the gap between the haves and the have-nots."

The economic literature has a great deal to offer to the debate on the future design of European welfare states. In a recent report entitled 'Reinventing the welfare state', CPB links the key insights from welfare economics to institutional reforms in the Netherlands. The broad welfare analysis aims to structure the policy debate, while simulations with an applied general equilibrium model provide a quantitative assessment of various reform directions.

### By Ruud de Mooij

The Dutch welfare state is under pressure. Future trends of aging and globalization render public finances unsustainable and worsen the position of low-skilled workers on the labor market. At the same time, welfare state institutions seem insufficiently adapted to changed socio-cultural circumstances. Moreover, they cause inactivity among elderly workers, women and social benefit recipients. To prepare for the future, the Dutch government aims to raise labor supply and improve human capital. The CPB report explores how welfare state reform can contribute to these goals. In doing so, it takes account of the various key social and economic functions that the welfare state fulfils in our society. These are labeled as the three R's of the welfare state.

### Three R's of the welfare state

The first R stands for *redistribution* between people who differ in their abilities. Interpersonal redistribution is desirable for equality. In redistributing income, however, the welfare state distorts decisions regarding labor supply and learning, while it exacerbates unemployment problems among the low skilled. Thus, society encounters the fundamental trade-off between equity and efficiency.

The second R refers to *risk*. The welfare state protects individuals against labor-market risks by providing social insurance. But insurance contracts are typically incomplete, thereby inducing moral hazard. For instance, people put too little effort in preventing risk, engage in excessive claim assessment and do not exit early enough from the insurance schemes. Thus, society encounters a trade-off between insurance and incentives.

The third R stands for *reallocation* of income over the life cycle. This is important in the context of lifelong learning, the combination of work and care for children, and saving for early retirement. Public intervention can help individuals avoid liquidity problems during these phases of life and provides commitment. Yet, it may induce distortions in decisions regarding saving, labor supply and retirement. Society thus faces a trade-off between commitment and flexibility.

### Shifting along or among trade-offs

The objective of the Dutch government to raise employment may call for a shift along the trade-offs. Indeed, society could obtain more employment, but at a cost of less equity, insurance and commitment. For instance, governments can reduce tax progression, cut welfare benefits and



Ruud de Mooij: "Reinventing the Welfare State along the lines of the three R's: Redistribution, Risk and Reallocation."

minimum wages, and shift from social insurance to individual saving accounts. Alternatively, governments can try to move the frontier of the trade-offs, i.e. towards better combinations. For instance, a government can improve the efficiency of the redistributive system by means of targeted relief for workers at the lower end of the labor market, where the participation margin is relatively elastic; or it can do so by targeted tax relief for secondary earners in couples who are relatively elastic with respect to their decision regarding the number of hours worked. Insurance contracts can be made more efficient if tight eligibility criteria, sanctions and workfare are able to raise exit from the insurance schemes. And liquidity problems can be dealt with more efficiently through mandatory saving accounts than through public transfers.

#### Three reform directions

The CPB study combines various institutional changes in three comprehensive reform directions. They are called the residual welfare state, the universal welfare state and the diversified welfare state. The prototypes show similarities with the popular typologies of the Anglo-Saxon, the Scandinavian and the Corporatist welfare states. Yet, CPB does not emphasize this because discussing welfare states in terms

of these 'models' turns out to cause much confusion in the public debate – as people tend to have very distinct ideas about what they actually reflect. CPB therefore emphasizes the different principles of design rather than country differences. The residual welfare state is characterized by a shift along the trade-offs away from redistribution, insurance and commitment. Solidarity with vulnerable groups is maintained via targeted support measures. A reform package along these lines is found to raise labor supply in the long term by 3% and to reduce unemployment by 2½%-point.

The universal welfare state focuses on moving towards a better trade-off. It shifts the marginal tax rate away from elastic partners and reduces the tax at the participation margin for the lowest skills. Insurance is complemented by sanctions and workfare. The universal welfare state moves away from commitment towards more flexibility. A reform package is found to raise labor supply by 1½% in the long term, especially due to higher female participation. The unemployment rate falls by 1¼%.

The diversified welfare state emphasizes commitment, long-term relations and decentralized solidarity in small collective groups. The state reduces redistribution and insurance, but this role is partly taken over

by social partners and local communities. A reform package is found to raise labor supply by 2% and to reduce the unemployment rate by ½%.

#### Policy challenge for today

The various welfare state reforms thus have the ability to improve labor-market performance. Yet, reforms are usually difficult to pursue politically. Indeed, they inevitably hurt vested interests and redistribute incomes – e.g. from insiders to outsiders on the labor market, from old to young, between rich and poor, and from single earner to two-earner couples. Note, however, that failure to reform the welfare state will probably require even greater and more painful reforms in the future. Thus, a no-reform strategy is not sustainable – and therefore not credible. Reforms require courage, and choices must be made now.

# Unique MSc: Economics and Finance of Aging

One of Netspar's main goals is to help practitioners at financial institutions to become more aware of the macro- and microeconomic implications of aging and the policies of their institutions. The new one-year MSc Program Economics and Finance of Aging, which starts in September 2006, is one of the ways in which Netspar will attempt to achieve this goal. The master's program was fully accredited in April by the Ministry of Education, Culture and Science. It is the first master's program in the world that focuses on the impact of aging on economics and finance from a multidisciplinary perspective. Both the MSc program and the individual courses are open to qualified employees of Netspar's partners.

By Arthur van Soest

Students in the new master's program at Tilburg University will obtain a broad scientific training in the macroeconomics, microeconomics and finance of aging and pensions. The program will equip them with skills and tools that can be used to help promote the quality of decision-making by organizations in the public and private sector concerned with pensions and aging. Courses will address pensions and other aging-related issues such as investment analysis, retirement and labour force participation, work disability, health insurance and healthcare, family networks and the macroeconomics of global aging.

Unique features

A unique feature of this program is that 'regular' students together with employees from Netspar participants will take part in the courses. This will create many opportunities to communicate and cooperate on coursework and assignments, for guest lectures, internships etc. Another special feature is that lectures will be given not only by Tilburg staff, but also by researchers affiliated with Netspar from all Dutch universities participating in Netspar. Prominent representatives of partners in the private and public sector will also give guest lectures. All courses will be taught in English.

State-of-the-art scientific knowledge

Students are equipped for careers in insurance companies, pension funds or related organizations with research staffs that employ scientific methods to develop long-term policies. Economic models and arguments are developed to aid decision-making by financial institutions and governments. The program includes state-of-the-art scientific work from the recent

literature in the field. As an appointed Societal Top Institute, Netspar combines excellent scientific research with involvement in the most important questions facing society.

Program overview

The table below provides an overview of the program. The first semester consists of mandatory core courses in the relevant disciplines. The second semester is split into two parts. In the first, students will select two courses from among several offered; possibilities include more advanced courses in one of the core disciplines (micro, macro, finance) and related disciplines, such as healthcare and psychology. The second part of the spring semester will be devoted to the Master's thesis, which will account for 30% of the total study load. Students are actively recruited in the Netherlands and abroad. Employees of Netspar's partners that are interested can obtain a brochure at their HR department.

More information can also be found at the website: [www.netspar.nl/master](http://www.netspar.nl/master)

Course	Credits
<b>Semester 1</b>	
Introduction to Economics and Finance of Pensions and Aging	6
Microeconomics of Life-cycle Behavior	6
Empirical Research in Pension and Retirement Economics	6
Investment Analysis of Aging and Pensions I	6
Macroeconomics of Pensions and Social Insurance	6
<b>Total</b>	<b>30</b>
<b>Semester 2</b>	
Two courses out of: - Psychology of Economic Behavior - Health and Aging - Investment Analysis of Aging and Pensions II - Topics in Economics and Finance of Aging * Actuarial Sciences: Life Insurance * General Equilibrium Models * Retirement and Taxation	12
Master's Thesis	18
<b>Total</b>	<b>30</b>
<b>Total</b>	<b>60</b>

# Granted Projects and Themes

Research themes have been introduced in 2006 as an important new strategic element to design exciting and relevant research projects. The first three themes started in April. Alongside the themes, several individual research programs for 2006–2007 have been selected. Here is an overview of Netspar's new research projects. Separate reports on selected individual research projects in Meso-, Micro- and Macro areas appear elsewhere in this issue of Netspar News.

### Funded research projects

Decisions to fund projects are taken by the Scientific Directors after consultation of the research board. The projects for senior researchers as well as for junior researchers that are not on tenure track contracts are funded for a period of one year. In order to be able to take optimally informed decisions on continuation of their participation in Netspar, all of these researchers present the research results generated in the year before at a pension day organized in February and March. Whereas theme coordinators select the researchers in a theme, program coordinators play a leading role in the selection (and evaluation) of the researchers that are not part of a theme.

### Introduction of themes

In addition to cultivating the individual programs, Netspar seeks to fuel entrepreneurship, commitment and focus by stimulating cooperation in 'themes'. These themes ensure the pursuit of a targeted approach towards one subject, and help to generate coherence in the overall research program.

In order to ensure that the applications fit Netspar's overall objectives, the scientific directors actively solicit proposals and comment on the draft proposals. Both the Scientific Council and the Partner Council evaluate the final theme proposals. Netspar thus ensures that the themes not only meet rigorous academic standards, but also correspond with the interests of the non-academic partners— all of which is in keeping with Netspar's primary mission of building bridges between academia and practitioners in the private and public sectors.

Netspar grants theme coordinators a substantial budget of €1 million. The theme coordinators have considerable discretion in allocating these funds within the limits of their budget plans. This amount of money should be sufficient to fund the research time of two Ph.D. candidates for a four-year period, four senior researchers for a three-year period, and two tenure-track assistant professors for a six-year period. All themes run for a period of three years. By April 2008, Netspar intends to run nine themes. Every year, one-third of these themes will be replaced by new themes.

### Theme 1:

#### Valuation and risk management for insurance companies and pension funds

##### Theme coordinators:

Antoon Pelsser (University of Amsterdam; from 1–9–2006 onwards) and Joost Driessen (University of Amsterdam; until 1–9–2006)

##### Senior researchers:

Peter Boswijk (University of Amsterdam)  
Marc Goovaerts (University of Amsterdam and KU Leuven); Rob Kaas (University of Amsterdam); Coen Teulings (University of Amsterdam and CPB)

### Finance meets actuarial science

Pension and insurance sectors are facing unprecedented challenges at the beginning of the 21st century: Equity markets have fallen dramatically, interest rates are at historical lows, and people are living longer than ever before. At the same time, new tools and financial markets are becoming available to address these challenges. Actuaries and actuarial science therefore need to enhance their skill-sets. The management of financial risks together with 'classical' actuarial risks is an area requiring further research.

This theme is designed to stimulate research precisely in the area where finance and actuarial science meet. The primary application of this theme is risk management and asset and liability management by pension funds and insurance companies, focusing on internal risk management and external supervision and regulation.



# Fuel Entrepreneurship

**Theme 2:**  
**Income, health and work across the life cycle**

Theme coordinators:  
Maarten Lindeboom (Free University, Amsterdam) and Eddy van Doorslaer (Erasmus University, Rotterdam).

Senior researchers:  
Gerard van den Berg (Free University, Amsterdam); Han Bleichrodt (Erasmus University, Rotterdam); Bas van der Klaauw (Free University, Amsterdam); Owen O'Donnell (Erasmus University, Rotterdam); Katie Carman (Tilburg University); Norma Coe (Tilburg University); Tom van Ourti (Erasmus University, Rotterdam); France Portrait (Free University, Amsterdam).

**Healthcare accessibility**  
The growing life expectancy of most Western populations entails many new challenges. If aging simply implied an expansion of the healthy and productive lifespan, it would not be considered the challenge that it is today. Unfortunately, much of the expansion consists of an increase in the number of years in declining health, accompanied by greatly increased healthcare needs and associated expenditures. As a result, most OECD countries face formidable new challenges for their largely publicly financed healthcare systems and for the optimal balance between active working life and the post-retirement, care-dependent years. Major dilemmas with respect to the sustainability of current retirement and disability programs, and the affordability of equitable healthcare systems, need to be addressed.  
This program aims to improve our understanding of affordable health insurance and healthcare delivery arrangements and the degree to which solidarity is feasible and sustainable. Of central interest is the relationship between income and health, which are closely associated and unequally distributed. Cross-country comparisons suggest that the degree of inequality in access to healthcare often depends on the way each society protects the income and health of its non-active portion of the working-age population. While we know that health- and income inequalities exist and are related, much less is known about their underlying causes and the effects of institutions and policy interventions. Most of the significant shocks with regard to health and income are incurred at later stages of the life cycle (i.e. just before or after retirement age), which makes these stages particularly relevant for studying the way in which income and health interact, and how this varies with different institutional arrangements regarding income- and health protection.

**Theme 3:**  
**Private retirement provision**

Theme coordinator:  
Peter Schotman (Maastricht University).

Senior researchers:  
Rob Bauer (Maastricht University, ABP); Piet Eichholtz (Maastricht University); Frank de Jong (Tilburg University); Bas Werker (Tilburg University)

**The third 'pillar'**  
The provision of retirement income has long been dominated by mandatory arrangements with little room for individual choice. However, individual choice is becoming increasingly important within collective defined-benefit arrangements. Moreover, individual schemes with more scope for individual discretion are sometimes proposed, including private retirement and life-cycle accounts based on defined contributions. In any case, in addition to collective pension rights, households build up private savings and investments in financial assets, housing and human capital. These developments place more responsibility on individuals to make informed decisions about retirement savings and investments. People must be able to estimate not only how much wealth they will need to accumulate by the time they retire, but also what risks are involved. To execute their plans, they will invest in mutual funds, or use the services of intermediaries, such as insurance companies and pension funds.

- This theme investigates three broad issues:
1. What is the optimal investment portfolio for households at various ages, taking into account housing and labor income?
  2. How efficient are various institutional providers, such as mutual funds and pension funds, in providing investment products for households?
  3. Do people have the capacity to make rational decisions about retirement?

## Individual Projects

### Micro Projects

**By Rob Alessie, program coordinator**

The micro program of Netspar analyzes retirement, financial decision-making and health on the basis of individual and household information. This (subjective) information stems both from panel surveys and from administrative records. This note outlines the individual projects that have been awarded mainly in the field of retirement choice and financial decisions.

#### Financial decisions

**Rob Alessie** (Utrecht University) is examining the degree to which the Dutch elderly reduce their home ownership, home equity and wealth holdings as they age, and the factors that determine this process. Rob will also investigate and explain generation effects in home ownership and wealth holdings. **Jan Rouwendal** (vu Amsterdam) is analyzing the changing financial risks associated with home ownership of the elderly by comparing the actual composition of the investment portfolios of the elderly with those of optimizing agents. Reasons for possible deviations will be analyzed. On the basis of this assessment, Jan will also discuss the effects of the tax treatment of owner-occupied dwellings.

In an environment of increased individual choice, an important question is to what extent individuals are able to make good financial decisions. Using data from the DNB Household Survey (DHS; an Internet panel), **Rob Alessie**, **Maarten van Rooij** (DNB) and **Annamaria Lusardi** (Dartmouth College, Hanover) find that the financial literacy is rather limited and significantly correlated with stock market participation. However, from this evidence one cannot claim that higher financial literacy causes more stock market participation. There is the problem of reverse causality: one also learns from participation in the stock market. Additional information from the DHS respondents will thus be collected, in order to assess the causal effect of financial literacy on stock market participation and wealth holdings. Using experiments, **Jan Potters** and **Eline van der Heijden** (Tilburg University) will investigate the equity premium puzzle, which states that given the historically observed returns of stocks, an unreasonably high level of risk aversion would have to be invoked to explain why investors would be

willing to hold bonds at all. This puzzle might be explained by the theory of myopic loss aversion (MLA). This theory rests on the combination of two behavioral concepts: loss aversion and mental accounting. Recent experimental tests on students have shown that observed behavior is consistent with predictions made by MLA. Obviously, it would be preferable to carry out such experiments on a representative sample of the Dutch population. Jan and Eline will therefore carry out similar experiments on the DHS respondents. **Fred van Raaij** (Tilburg University) will also take a behavioral approach, including both economic and psychological concepts to explain financial behavior of individuals and households. **Peter Kooreman** (University of Groningen) and **Henriëtte Prast** (Tilburg University) will analyze default and labeling effects in saving decisions using a field experiment. The field experiment concerns the participation phase of the 'Levensloop-regeling' (life-course arrangement). Each year, employees can choose to participate in either the 'Levensloopregeling' or the 'Sparloonregeling' (savings arrangement). The latter is the default option for virtually all employees. Peter and Henriëtte are currently discussing with a medium-sized employer the possibility of changing (and preferably randomizing) defaults when a new choice opportunity arises.

#### Retirement choice

To understand individual decisions regarding retirement, **Arthur van Soest** (Tilburg University) and **Arie Kapteyn** (Tilburg University and RAND) have conducted a 'stated-preference experiment' in which DHS respondents are presented with a number of hypothetical choices. It turns out that many people resist the idea of working full-time after the age of 65. Working part-time after that age is a much more popular option.

The effect of financial incentives on retirement can also be investigated by using institutional variation across countries or across different industrial sectors within a country. **Klaas de Vos** (Tilburg University) and **Arie Kapteyn** are participating in the international comparison project directed by Jonathan Gruber and David Wise. The various studies in this project invariably find substantial effects of financial incentives on

early retirement. Those studies, however, do not consider the relation between individual retirement and saving behavior. Earlier research of **Hans Bloemen** (vu Amsterdam) on the Dutch Socio-Economic Panel has shown that *ceteris paribus* a higher net wealth, but also higher total savings, lead to higher exit rates into early retirement, whereas higher outstanding debt, including mortgage debt, leads to a lower exit rate via this route. These findings are preliminary, however, because Hans likes to use more refined econometric techniques to assess the effect of net worth on retirement choice.

Using a Danish administrative dataset, **Stefan Hochguertel** (vu Amsterdam) will study the retirement behavior of self-employed individuals and also the transition from employment to self-employment as an alternative for retirement around the ages of 55–65 years. Little is known about the retirement behavior of the self-employed. This group has recently received increased policy attention because of the hope that self-employment *per se* can relieve the pressure on pay-as-you-go retirement systems.

**Matthijs Kalmijn** (Tilburg University) will continue to work on his research project 'Aging in a life-course perspective'. This project investigates the effects of demographic transitions (such as leaving home, divorce, remarriage and widowhood) on income, employment (retirement behavior) and well being. Matthijs is also interested in the topic of solidarity between generations.



Rob Alessie

## Meso Projects

By Frank de Jong, program coordinator

The institutional program of Netspar brings together researchers who work on the role of financial institutions in retirement provision. These institutions include not only pension funds, but also (life) insurers and mutual funds. Apart from the theme project related to this line of research (see elsewhere in this issue), there are also individual projects. Five research proposals have been selected for the coming period:

### Mutual funds and hedge funds

**Marno Verbeek** (Erasmus University, Rotterdam) will perform research on mutual funds and hedge funds. Both individual and institutional investors extensively use such professional money managers. In this project, Marno investigates the performance of mutual fund and hedge fund managers and their performance persistence. Further, he investigates how private and institutional investors respond to past performance in their investment and divestment decisions, and analyzes the subsequent performance of their allocation decisions. Particular attention will be paid to the relevance of existing and new research results for pension funds. For example, how can pension funds improve their allocation to hedge funds in an asset liability context?

### Risk management and solvency of pension funds and insurers

**Hans Schumacher** (Tilburg University) focuses on risk management and solvency of pension funds and insurers. New regulations are being implemented in this area, while at the same time a debate is still going on about the principles behind solvency rules. This project investigates alternatives to the existing rules, aiming for reduction of pro-cyclical effects and prevention of undesired incentives for pension fund managers. Part of the work in the project is also useful for implementation of the current regulatory framework— in particular, concerning market valuation of liabilities.

### Longevity risk

**Anja De Waegenaere** and **Bertrand Melenberg** (Tilburg University) will look at various aspects of longevity risk. At present,



The longevity risk

efficient tools to hedge the longevity risk are basically non-existent. Longevity bonds were introduced in the UK, but were not very successful. Alternatively, pension funds could hedge their risk by means of reinsurance contracts, but because there is no market for longevity risk, it is unclear how these products should be priced. However, some degree of risk reduction could be obtained by combining products for which increased longevity implies a risk with products for which decreased longevity implies a risk. Regarding pension payments, longer-than-expected lifetime implies higher payoffs — but the opposite holds for life insurance products that pay off when the insured person dies. Since it is common practice to combine pension payments with widower's payments, it would be interesting to investigate to what extent this combination mitigates the problem. Recently developed techniques in the area of robust optimization could help to mitigate potential sensitivity of optimization results to the uncertainty inherent in the parameter estimates of the mortality forecast model.

### ALM for pension funds

Finally, **Ronald Mahieu** (Erasmus University, Rotterdam) is working on a proposal about ALM for pension funds. Specific questions that he would like to answer are the

following. Are the current strategic and tactical asset allocations sufficient to cover the long-term liabilities? How does the change to market-based valuation of liabilities impact these performance measures? Could alternative investment sources, like hedge funds, commodities, and real estate, significantly improve the performance of pension funds? To what extent is the FTK a binding factor on the investment policies of pension funds?



Frank de Jong



## Macro Projects

By Ben Heijdra, program coordinator

Following the selection presentations that were held during the first three months of this year, nine senior researchers were appointed for the period 2006–2007. As is to be expected from a network like Netspar, the selected researchers are based at various universities in the country: *Roel Beetsma* (University of Amsterdam); *Jan Boone*, *Sylvester Eijffinger*, *Harry Huizinga*, *Lex Meijdam*, and *Harrie Verbon* (all of Tilburg University); *Kees Koedijk* (Erasmus University); *Clemens Kool* (University of Utrecht); and *Ben Heijdra* (University of Groningen). Together with junior researchers, this group of experienced researchers forms a high quality research 'branch' of the Netspar 'tree'.

As the newly appointed program coordinator for macroeconomics, I will attempt to provide a taste of the kinds of topics that will be the focus of the macro group. Broadly put, the research projects can be subdivided into three broad groups, namely (a) Theoretical, (b) Empirical, and (c) Comparative Institutional. Of course, some projects can easily be placed in more than one subgroup.

### Theoretical

The theoretical projects in the macro program all make use of highly stylized overlapping-generations models. Whilst these models – by their very nature – cannot capture all of the intricate details of actual pension systems and the exact process of aging, they are nevertheless useful because they allow the analysis of the core general equilibrium processes affecting the macro economy in the long run. As such, these small-scale core models can provide insight complementary to the results obtained from highly detailed computable general equilibrium models (such as Netspar's IMAGE project). *Roel Beetsma* studies key policy tradeoffs involved in the recent reform of the Stability and Growth Pact; *Jan Boone* uses insights from optimal taxation theory to study retirement incentives and redistribution; *Ben Heijdra* tackles the issue of aging, pension reform and the relative price of non-traded goods, whereas *Lex Meijdam* and *Harrie Verbon* deal with international spillovers operating through international



'Levensloop' / Life-course

capital markets and a common monetary policy within EMU.

### Empirical

Because population aging is a rather gradual phenomenon, taking many years to complete, it is rather difficult to use standard econometric methods to empirically investigate its economic consequences. Consistent long-term data series are simply not available and will not become available any time soon. For this reason, the empirical research in the macro program looks more in detail at specific mechanism that may be affected by aging and pension reform. For example, *Kees Koedijk* studies the behavior of institutional investors who typically seek to fulfill both financial and social obligations. He investigates whether the strategy of sustainable investment will reduce portfolio investment and, if so, what the transmission channels are by which this occurs. In a similar vein, *Clemens Kool* focuses on an international transmission mechanism by studying to what extent the geographical pattern of Dutch foreign assets and liabilities in the past has influenced returns and volatilities.

### Comparative institutional

The final subcategory of the macro program takes a comparative institutional approach

to study the consequences of aging and pension reform. *Sylvester Eijffinger* studies the issue of financial supervision in Europe. He identifies two key dimensions of supervision, namely centralized vs. decentralized, and sectoral vs. cross-sectoral supervision. Recently developed theories of regulation may shed important insights on the optimal design of institutions.



Ben Heijdra



# Successful Pilot Study Netspar–CBS

To improve the availability of microdata for research, Statistics Netherlands (CBS) has introduced the possibility of accessing datasets via 'Remote Access', thereby offering researchers the possibility of accessing CBS microdata in their own office via the Internet. CBS, in cooperation with Netspar, started a pilot project in Tilburg in September 2005. One objective was to evaluate the technical feasibility. Netspar also sought to gain insight into what type of analyses are possible— one exciting possibility being the matching of survey data with administrative data, and with microdata from pension funds. This article summarizes the experience thus far. An elaborate interim report has been submitted to Netspar and CBS.

**By Klaas de Vos (Netspar and CentERdata)**

### Procedures

Researchers access the CBS data using a separate PC via a secure Internet site. The user is identified by means of a fingerprint reader, and can then login with a username and a password. CBS provides directories on which the user can store programs and interim results. The user cannot copy data or results to his local environment or, for example, to a printer. The experience thus far shows that the most vulnerable link is the fingerprint identification. Once the login procedure is successfully completed, the work on the data usually proceeds smoothly.

Before results can be obtained locally, they are checked by CBS. When the results satisfy CBS's regulations on non-disclosure of information about individual persons, the user receives them via e-mail within half a day. Obviously, once remote access is available on a larger scale, it might not be possible to guarantee such a short processing period.

### Datasets

Thus far, the datasets available via Remote Access include datasets on all recipients of social assistance, disability and unemployment benefits (1998–2004), and information on virtually all jobs (including

earnings). In contrast, EBB (2000–2003) and IPO (1989–2000) are smaller surveys covering the total employable population and the total population, respectively. For a picture of the total population, the IPO data are the most useful, and include the most complete income information.

Some preliminary results obtained from IPO are presented in the interim report mentioned above. There are many possibilities for obtaining further results. Some of the other datasets currently available can be used to check IPO information and enrich it. The data are part of the so-called Social Statistical Database, SSD. However, not all SSD data are currently available, and a list of additional datasets and/or variables that could be made available would be extremely useful. Interested Netspar researchers could then be invited to jointly submit a detailed request for additional data, with an indication of priorities.

In addition, one wave of the DNB Household Survey (DHS) is currently being matched with the demographic register data. If successful, this would enable researchers to check to what extent the DHS data are representative, whether the DHS income information matches with administrative data, and then to link the DHS information with income data from registries. In particular, retirement and

wealth accumulation could be analysed more carefully.

### Research perspectives and challenges

Interesting research perspectives will arise in the event that pension fund data are made available. These data would allow a precise picture of the retirement assets and incentives. Thus far, consultation with pension funds indicates a general willingness to provide data for the purposes of Netspar's research.

To summarize, the remote access facility turns out to be a practical instrument for the analysis of the available datasets. Identification via fingerprints has not been problem-free, but experience shows that it can work well. With respect to the data, work is in progress to make available the DNB Household Survey, and to obtain pension fund information. CBS plans to make 'remote access' available on a large scale in the near future.

## Partner Profile

# Fortis



Peter Ronteltap, sales manager Fortis Pension Fund Services

Fortis has been one of Netspar's partners from the very beginning. This Partner Profile, written by Peter Ronteltap, sales manager, describes the Fortis organization, and focuses on the service provider's interactions with the Dutch pension funds. The profile wraps up with an assessment of current and future collaboration between Netspar and Fortis.

### Who is Fortis?

Fortis is an international financial service provider in the field of banking and insurance. To our private, corporate and institutional clients, we offer a wide array of products and services via our own channels, in cooperation with insurance intermediaries, and through other distribution partners.

With a market capitalization of 33 billion euros, Fortis is in the top twenty of the largest financial institutions in Europe.<sup>1</sup> Our strong solvency, our presence in 44 countries, and the dedication and professionalism of our 56,000 staff enable us to combine global power with local flexibility, a combination that warrants optimum service provision.

### What developments does Fortis observe in the Dutch pension fund market?

The Dutch pension fund market is fully in motion. The strong volatility of share markets over the last few years has impacted the coverage of the Dutch pension funds. The continuing low interest rates, moreover, have pressured pension fund returns. In various areas, pension funds are also facing complex legislative adaptations. The solvency requirement, for instance, is being tightened up (new Financial Assessment Framework), the nature of the pension payout is being adjusted on a large

scale (from final pay to average salary), and the IFRS is enforcing a better-attuned investment policy. Pension funds are also engaging in the debate on 'how to deal with pension fund governance.' Dutch pension funds are thus, more than ever before, looking for new, flexible and practical solutions.

### How does Fortis interpret its partnership with pension funds?

Fortis is a major supplier of services to Dutch pension funds. These services may include pension fund administration, investment administration, global custody, securities lending, performance measurement, asset management, active currency overlay, re-insurance and pension fund governance.

Pension fund administration, for example, is becoming an increasingly complex operation for a pension fund to carry out. To guarantee continuity and to save on expenses, a pension fund may choose to contract out its administration to Fortis, which means that the pension scheme is implemented in our pension administration system. To this end, Fortis Pension Fund Services has developed a new, highly advanced and flexible pension administration system that has proved to be very successful. An important starting point here is that the pension fund maintains its



own identity. We work with practical modules: participant's administration, reporting, management support and communication support.

We also have a great number of specialists who can advise pension funds about instruments on the money and capital markets, the currency market and the stock market. Fortis pursues long-term relationships with the Dutch pension funds and wishes to help its customers to find the best possible solution.

#### Why is Netspar important?

For a financial institution like Fortis, it is very important for there to be an umbrella organization that deals with pension-related matters in a thorough and academic fashion. Before Netspar was founded, the Netherlands lacked a top institute in the field of pensions with a clear vision and a bird's eye view.

An institute was needed that could translate academic research findings into practical recommendations for the public and private sectors. The absence of such a pension-specialized top institute was something of an oddity, since there are quite a few private and public parties in the Netherlands that have major – joint – pension-related interests and responsibilities. Moreover, the Netherlands has a great deal of expertise in the field of

pensions in all three pillars of the Dutch pension system, and therefore is well positioned from the point of view of international exports.

As a top institute, Netspar can meet the needs of both public and private parties and can also help to promote pensions as an export commodity.

Netspar's division into macro-, meso-, and micro-research teams is a logical and familiar one for Fortis, enabling it to make sound pension-related choices in both the present and the future. Issues that matter to Fortis include the following:

- at the macro-level: issues relating to aging, solidarity between generations on premium contributions, and differences in pension systems and tax systems among the various European countries;
- at the meso-level: the increasingly tighter supervision of financial institutions and the increasing complexity of pension legislation;
- at the micro-level: dealing with maintenance and information requirements regarding investment choices and flexible elements (how, for example, does a switch in the kind of pension affect the retirement date?).

#### What is the shape of the future collaboration between Netspar and Fortis?

Fortis is interested in contributing to Netspar's increasing success. With Netspar, we are presently investigating possibilities for making a practical contribution to a number of Netspar Pension Days. We regularly present highly topical subjects at the annual Fortis seminars for pension funds – to the evident satisfaction of these pension funds themselves, particularly with regard to their practical applicability. The more practically-oriented Fortis workshops could serve as an excellent complement to the more academically-oriented Netspar workshops (when dealing with the same subject). This would bring about a balanced mix between the concerns of scholarship and practice. In addition, we are investigating possibilities for Fortis to participate in several ongoing Netspar research projects. As a partner of Netspar, finally, we regularly supply participants for the 'Outer Ring'.

<sup>1</sup> Source: *Fortune* Global 500, July 25, 2005.

# Netspar at the National Innovation Event



Visitors discuss the ideal pension in the Netspar stand

By Rob Bakker

### Background on the Innovation Platform

Over the course of 2002, there was a growing sense of urgency concerning the harmonization of approaches to improving the innovativeness of the Netherlands. Many organizations advocated the establishment of a national coordinating body, referring to the Science and Technology Policy Council (STPC) in Finland. Founded in 1987 under the chairmanship of the Finnish president, the STPC unites representatives from the cabinet, the corporate world, research agencies and education. With a view to the much-needed integrated approach in the Netherlands, the Dutch government established the Innovation Platform (IP), which was launched on January 1, 2004. The IP comprises representatives of the ministries involved in education and innovation policy and representatives of relevant social parties, such as trade and industry and knowledge-based institutions, and is presided over by the Prime Minister. Despite across-the-board cutbacks, the cabinet reserved additional funding for innovation, which will be allocated to promising initiatives through the platform. The IP's mission is to reinforce the innovative power of the Netherlands so that the country will be a strong player in the





European knowledge economy by 2010. Since 2004, innovation has been a priority issue on the political agenda in the Netherlands.

#### National Innovation Event

On December 7, 2005, the IP staged a large-scale National Innovation Event. Participants were given an interim assessment of the degree to which innovations were being actualized and learned which initiatives would be granted financial support. An important side benefit of the Event was the opportunity for people and organizations to mix and mingle and exchange ideas. Organizations that focus on social innovations were expressly invited to present themselves at the Event. Netspar's market partners did not hesitate to accept this invitation.

#### Netspar's participation

The IP currently faces the challenges presented by the fact that the Netherlands is currently under exploiting its human and economic potential. One of the factors concerned here involves the opportunities and challenges offered by the Dutch pension system to the improved utilization of labor and capital. Netspar, which was recently recognized as a Societal Top Institute, focuses on mapping out the opportunities and challenges inherent in

Panel discussion moderated by Herman Wijffels (r.), with from l. to r.: Jan Nijssen (ex-ING Pension Services), Karel Noordzij (ex-PGGM), Joep Schouten (Cordares), and Lans Bovenberg (Netspar)

this internationally respected pension system. Netspar pursues this aim by carrying out fundamental research into the economics of pensions, by developing academic curricula that are open to promising sectoral representatives, and by offering a platform where all of Netspar's partners dialogue on jointly agreed-upon themes.

After intensive consultations with ABN Amro, ABP, Achmea, Aegon, Fortis, Interpolis, Mn Services, Cordares, and ING, Netspar – in conjunction with Cordares and ING – decided to realize its participation in three ways:

- having a stand at the Event;
- conducting a survey among visitors with questions relating to the relations between pensions, the labor market, and the economy in an aging society;
- a panel discussion by several representatives of Netspar's partners, who discussed three themes:
  - pension innovation by way of pensions in-kind (accommodation, transport, medical care) instead of or in addition to financial pension payments;
  - export opportunities for the Dutch pension system, such as pension system

organization, the set-up of implementing bodies, and advanced counseling in the field of product development and investments;

- innovations that can be realized by means of the life-course savings scheme, a tax-supported scheme allowing individuals to save for a caregiver's leave (to take care of children or parents), for study and self-development, and for early retirement.

#### In conclusion

The National Innovation Event was a great success, attended by well over 2000 innovators. In his speech, Prime Minister Balkenende looked both back and ahead: 'We are not quite there yet, but a lot has been achieved. The government will continue to feel responsible for the innovation climate in the Netherlands. Innovation will remain a top-ranking item on the agenda: it is not a fashion fad.'

# Second Netspar Workshop From Pension Plan Design to Extending Working Life

Netspar held its second Pension Workshop in Maastricht on 18 and 19 January 2006, drawing economists and pension experts from throughout the country. Once again, Netspar loaded the agenda with an impressive blend of experts in the field of aging, pensions and retirement. The guest speakers for the two-day event, which merged academic research with public policy implications, were Jeffrey Brown, from the University of Illinois, and Richard Blundell, of University College London, and Research Director at the London-based Institute for Fiscal Studies (IFS). Gerrit Zalm, the Dutch Minister of Finance, delivered the keynote address, followed by a question-and-answer session with graduate students from Maastricht University, which hosted the policy-oriented afternoon session on the second day of the workshop. The sessions on the first day and a half were held at the picturesque 12th century estate Chateau St. Gerlach, situated on the Geul River in the heart of Limburg.

By Margaret Kavanagh

### The problems are easy; it's the solutions that elude us

H.L. Mencken once said: "Old age ain't no place for sissies." And, while the featured speakers at the Netspar Pension Workshop may have stated their positions a bit more eloquently, their conclusions weren't very different from that of Mencken. Every industrialized society is struggling with the question of what to do with an increasingly aging population, which is ill prepared for retirement. Although there seems to be a general consensus regarding the problems that will arise as the baby-boom generation edges ever-closer to retirement age, an enormous chasm exists when it comes to devising and implementing solutions to those problems.

### Gandhi weighs in on the issue

More than 60 years ago, Mahatma Gandhi was quoted as saying: "Men and women approaching retirement age should be recycled to public service work, and their companies should foot the bill. We can no longer afford to scrap-pile people." Gandhi was speaking about a newly emerging nation whose circumstances were far different from those of today's industrialized countries, yet his words resonate with the issues that economists and public policy

decision-makers grapple with today: what to do with a large population of people who have reached the official retirement age, yet are still able-bodied and capable of contributing to society? Every speaker at the pension workshop made reference to this burgeoning cohort of people who, voluntarily or involuntarily, exit the work force at an age that was determined under very different circumstances—when life expectancy was much lower than it is today and when the economy was capable of sustaining them post-retirement.

### Stepping up to the plate

Workshop organizers were forced to modify the agenda because of an unfortunate traffic accident involving one of the two major speakers, Richard Blundell, which prevented his attending the first day's sessions. But, like a well-oiled machine, they quickly shifted gears, and Jeffrey Brown stepped up, without missing a beat, to deliver virtually all of his material on Wednesday. As a special advisor to President Bush and the White House Council of Economic Advisors, he is accustomed to sudden and unexpected schedule changes. Despite his relatively young age, Brown has compiled an impressive list of credentials, earning graduate degrees at two of the world's most prestigious universities, Harvard and the Massachusetts Institute of

Technology (MIT). It was at MIT where Brown cultivated his fascination with public finance and policy issues. He has been nominated by President Bush to serve on the Social Security Advisory Board, a position that requires Senate confirmation.

### Dinner table discussions launch a stellar career

In a brief interview between sessions, Brown attributed his interest in public policy to the example set by his father, who taught Government at a local high school. "Discussions about current events and public policy were a regular feature around the dinner table when I was a kid, and I guess that's when the bug bit me," he said, adding, "I've always been interested in public policy and how it affects individual people's lives." At MIT, his thesis advisors served as Brown's inspiration to further explore public finance, a subject he continues to find fascinating, both as an academic pursuit and as a public policy focus.

He expressed concern about the lack of information people have at their disposal to make rational choices about retirement. When asked whether he believes the average American is aware of the seriousness of the situation regarding the solvency of the Social Security system, Brown said "It's heartening to me to see so



From l. to r.: Lans Bovenberg (Netspar), Gerrit Zalm (Minister of Finance) and Peter Schotman (Maastricht University/Netspar)

many letters to the editors of local newspapers from ordinary citizens that display a fairly good grasp of the problems. What they don't seem to understand is what it will take to resolve those problems. No one wants to pay higher taxes or accept a reduction in benefits, but both of those things will have to take place if we really want to get a handle on Social Security." When asked if President Bush was aware that he advocates raising taxes when he nominated him to the Social Security Advisory Board, Brown laughed and said, "Raising taxes isn't my first choice, but I'm a realist. Solving the Social Security problem will require a bipartisan effort, and the Democrats will never get on board unless additional revenues are part of the equation, and that means raising taxes."

#### A range of topical expertise

While clearly an expert on the US Social Security system, Brown did not limit his lectures to that topic alone. He also discussed the question of private versus public long-term healthcare insurance, suggesting that the presence of public insurance, in the form of Medicare and Medicaid, could potentially open the American people to more risk than would be the case under a wholly private insurance system. He also discussed pension plan design and individual portfolio

decisions, focusing on the role of life annuities as a means of insuring against longevity risk. A review of the literature bolstered Brown's contention that life annuities should be an essential part of individual portfolios; his final formal lecture offered a comprehensive overview of the current state of Social Security in the US and its future prospects.

#### A lifetime of achievements

Richard Blundell has spent most of his career examining key economic issues and their effect on public policy decisions. He manages to juggle several different jobs, as David Ricardo Chair of Political Economy at University College London, in addition to serving as Research Director at IFS and Director of the Economic and Social Research Council (ESRC) Center for the Microeconomic Analysis of Public Policy. He has received numerous awards and honors for his groundbreaking work, and was awarded the Commander of the British Empire (CBE) for his contributions to the social sciences in this year's New Year Honours, a distinction presented by Her Royal Highness Queen Elizabeth II of England. During an informal interview, Blundell spoke with more humility than pride about this impressive honor. He was much more interested in discussing his research than the accolades resulting from a lifetime of

work in important areas of study. He spoke enthusiastically of the work being done at IFS, an independent, policy-driven research institute. "People know they can trust IFS to produce the highest quality work that is independent of any government agency or private company." To ensure its autonomy, IFS does not allow any research to be funded by a single entity. In the area of pensions, for example, the research is funded by a consortium comprised of private institutions, government entities and the bank of England.

#### Merging public policy with scientific research

When asked how the work he does can help clarify the public's understanding of retirement options, Blundell replied, "Our objective is to disentangle myopic, irrational behavior from the surprises that happen to people. When the unexpected happens, such as a pension fund failure, people should be covered. I believe that people make reasonable decisions given the information available at the time. But too often, they just don't have the information they need to make the right decisions." He went on, "Many people have chosen to retire early. That was a rational decision





L. to r. Richard Blundell, Gerrit Zalm and Jeffrey Brown

when the economy could sustain it. But now, with the weakened economy, the environment is no longer favorable, and people have to be prepared to adjust to the changing environment or they simply won't have enough resources to support themselves in their retirement." He contends that the government should intervene without creating distortions and exacerbating problems down the road.

He sees the role of economic research as that of "putting together the big picture," so that individuals as well as companies and government entities are not left to make decisions based on isolated situations. When asked why he chose to devote so much of his energy to the issue of pensions, Blundell replied, "It's a key economic issue with a whole host of components. And it's one that affects so many people's lives. It brings together science and policy in a way that is very interesting."

#### Bloodied, but unbowed

Despite the pain resulting from his traffic accident the previous day, Blundell captivated the audience with his discussion of models for evaluating economic incentives for retirement and the impact they have on retirement behavior. He

contrasted the option value approach with other approaches, and showed the importance of accounting for joint retirement decisions among couples. In addition, Blundell presented simulations for a set of incentives reforms designed to discourage early retirement. Because of the agenda change, he was forced to compress two lectures into one, offering an abbreviated discussion of the differences between defined benefit (DB) and defined contribution (DC) retirement plans. He highlighted the importance of providing incentives to plan for retirement through savings to ensure a stable retirement income. In his last major lecture of the day, Professor Blundell discussed the public policy issues surrounding retirement, cautioning decision-makers to consider whether the financial support offered to retirees is sustainable in terms of the burden it places on those still in the labor force. In addition, he emphasized the importance of ensuring that the mechanisms by which the private financial sector helps people save for retirement are sustainable in their apportionment of risk among employers and employees. Finally, he examined the interaction between public and private pension systems, stressing the importance of providing a reasonable level of security without creating disincentives to work and save. Blundell also offered his findings on some of the important elements that will help shape future trends with the aim of extending working lives.

#### Finance Minister elucidates government initiatives

Rounding out the two-day event was a keynote address by Finance Minister Gerrit Zalm, entitled: "The Dutch Pension System: State of Affairs and Dilemmas." Zalm spoke of turbulence in the pension sector, characterized by sharp declines in assets, low interest rates, and a steep rise in pension fund obligations. He described some of the measures the Dutch government has implemented to offset the adverse effects of financial setbacks in pension funds. Most significant among these measures is the Financial Assessment Framework (Financieel Toetsingskader – FTK), which was the subject of a Netspar mini-conference held in Rotterdam in

September 2005, and which will take effect in 2007. He explained some of the basic changes the FTK will bring about in the manner in which pension funds are managed, intimating that the new regulations will result in a stronger, more sustainable system, which will provide better security for pensioners. Zalm strongly defended the controversial one-year recovery rule in the event of under-funding, pointing out that sufficient flexibility has been written into the regulations to allow for exceptions under special circumstances.

#### Facilitating better communication

According to Zalm, the current government is making an effort to improve communication between pension funds and their members, citing as an example the new Pensions Act, which establishes specific guidelines to ensure that pension fund members fully understand their rights as well as the risks inherent in any investment instrument. While lauding the changes that have been made, he called for increased transparency, particularly with regard to the funding ratio of indexed pensions, so that beneficiaries are less likely to be blindsided in the event of further declines in benefits. Zalm argued that the responsibility for improved communication rests not only with the pension fund managers; pension fund participants must also take an active role in understanding the terms and conditions of their pension benefits, which for many families is the second most important financial asset after their homes. He said, "People cannot afford to take for granted such a significant factor in their long-term financial survival." He cited with dismay a recent survey by the Dutch Central Bank, which indicates that a large percentage of people have no interest in learning the facts about their pension schemes or in making the right choices for their financial futures.

#### Facing future challenges head-on

In his final remarks, Zalm discussed the challenges the Dutch economy will face in the future. The key factor in these challenges is the change in demographics. Like most industrialized nations, the Dutch population is aging as a result of declining birth rates and increasing life expectancy. Changes have already been made in the



# Brainstorm Meeting May 10<sup>th</sup>: Indexation Quality

form of stricter requirements for unemployment and disability benefits and curbing early retirement. But, according to Zalm, this is not enough. He called for raising the effective retirement age as an essential factor in resolving this escalating problem. People are able to be productive for much longer, thanks to improvements in healthcare and other social factors. He warned that clinging to an outdated notion of the age at which people cease to be productive members of the workforce is no longer tenable.

In tandem with this change, he called for more intergenerational solidarity – sharing the responsibility, the risks and the rewards. Herbert Hoover, who was the US President during the Great Depression, famously said: "Blessed are the young, for they shall inherit the national debt." Zalm made it clear that this is not the future we should impose on our children and grandchildren. "The burden should not be placed solely on the shoulders of the young, but should be spread more equitably across society."

### Evolving perceptions of the government's role

Changes in the way people view the role of the government in ensuring a system that is both equitable and sustainable are necessary. Steadily increasing taxes and adopting a paternalistic approach will not provide the answer. We can learn a lot from the experiences of other countries that have already made some difficult – and often unsuccessful – choices. "Right now," Zalm said, "there seem to be more questions than answers. But the answers are out there. We just have to be prepared to accept some of those answers, even if they mean making fundamental changes in the way in which we view our society and our government."

Following his remarks, a group of seven graduate students from Maastricht University posed questions for Zalm, challenging some of the views presented in his address. At the conclusion of the question-and-answer session, the proceedings were adjourned – although the debate continued during the closing reception hosted by the Maastricht University Faculty of Economics and Business Administration.

Indexation of pension rights can no longer be taken for granted, and will often depend on the investment returns of the pension fund. The draft of a new Dutch Pension Law that is currently discussed in Parliament emphasizes the need for transparency of the indexation quality of a pension scheme. On May 10<sup>th</sup>, Netspar organized a brainstorm meeting with the aim to exchange ideas on better measures of the indexation quality of a pension scheme.

Klaas Knot (DNB) explained the indexation matrix that is currently under discussion in Parliament and outlined the underlying assumptions and limitations. Jan Baars (PGGM) expressed his reservations regarding the extent to which participants will understand the complicated standard phrases that are foreseen in the new law. He argued for a simple classification of pension schemes in five categories. Jan van Miltenburg (AFM) presented the way in which the revised Financial Information Leaflet represents investment risks in complex financial products through graphical illustrations. Theo Nijman (Netspar) then presented a measure of indexation quality that generalizes the approach taken in the Financial Information Leaflet. He emphasized that the indexation quality of a scheme can be age-dependent, and that temporary indexation cuts are most likely to affect the older generations. He also argued that the measure could be extended to encompass pension quality, which would also measure investment risk in DC schemes and/or insufficient pension coverage.

# Senior Pension Industry Professionals Support



Dick de Beus



Jean Freijns

To improve the channels for dissemination of knowledge and to increase involvement of non-academic partners, Netspar appointed four fellows who have substantial professional experience in the Dutch pension and insurance sector: Dick de Beus (ex-PGGM), Jean Frijns (ex-ABP), Jan Nijssen (ex-ING), and – recently appointed fourth fellow – Jan Overmeer (ex-AEGON). Netspar expects to benefit from their advice. From their vast experience they will assist Netspar on how to facilitate interaction between academia and practitioners and serve as Netspar's ambassadors. A brief portrait of the four Netspar fellows.

**Drs. Dick J. de Beus** is advisor to the Board of PGGM where he was chairman from 1988 till 2004. Furthermore, De Beus is Non-Executive Director of F&c Asset Management plc. in London, Chairman of the Advisory Board of Stichting Nederlands Philharmonisch Orkest and Nederlands Kamerorkest. Dick de Beus holds board positions at Kas Bank NV, 's Heeren Loo Zorggroep, KfN Holding NV and Vesteda Groep BV. He is also a member of the investment advice committee at the Gasunie Pensionfund and serves as advisor to several other organizations.

**Drs. Jean M.G. Frijns** was head of investments and member of the Board of Directors at ABP. He is professor by special appointment on investment theory and coordinator of the post-graduate education Corporate Compliance at VU Amsterdam. Furthermore, Frijns is chairman of the Monitoring Committee Corporate Governance Code and is on the board of the Nederlandse Waterschapsbank and the Kempen Bank; he is a member of several investment committees, such as PGGM, Pension fund Progress and Instituut Gak.

**Drs. Jan A. Nijssen** held several positions at Nationale-Nederlanden and ING. In 1993, Nijssen became Global Head Pensions ING Group and Member Executive Commissions Americas, Asia/Pacific, Europe. From July 2004 till January 2006, Nijssen was CEO of Central Europe Insurance. As of January 2006 he is a member of the Advisory Board Expert Centre 'Leeftijd'.

**Drs. Jan M. Overmeer** was a member of the Board of Directors at AEGON Nederland N.V. from 1990 to 2006 and responsible for asset management. After his retirement in April 2006, he became advisor to AEGON and VGZ and is a member of the investment advice committee of BPF and OPF (AKZO NOBEL, Gasunie, IBM Nederland, PGGM, BPF Vervoer). Overmeer is interested in activities that aim to build a bridge between theoretic developments and practice.

# stry t Netspar



Jan Nijssen



Jan Overmeer

## Events

### March 28<sup>th</sup>: Netspar Anniversary Meeting

Netspar's first anniversary was celebrated on March 28th with a meeting with Netspar's prime stakeholders. High-ranked representatives of all partners and representatives of the social partners discussed Theo Nijman's presentation of what has been achieved in Netspar's first year and what the priorities should be for the near future. Among the priorities: improved labelling of all the activities that have been organized and interaction with partner representatives at an early stage.

Coen Teulings explained his proposal to set up generational accounts, and argued that these could be used to increase transparency and to define property rights for what is commonly known as the solvency buffer of the fund. This buffer can alternatively be interpreted as risky investments of specific generations that can be used to provide indexation. Teulings argued that solidarity could be assured in a system with generational accounts where risks are transferred through financial markets.

Lans Bovenberg argued that the Dutch three-pillar pension scheme is extremely valuable. It should therefore be innovated – to benefit from new opportunities to trade risk on financial markets and to address new developments such as frequent job changes and the aging of the population. He argued that less costly guarantees for young generations are desirable, and that the current average-pay conditional indexation schemes have made significant steps in the right direction. He emphasized the need to take into account labour market effects and to improve the opportunities for older workers in order to avoid deterioration of their human capital.

A lively debate with all participants present concluded a very fruitful meeting.

# Short News

## First Annual Report

In April Netspar's first annual report was published. It provides information on Netspar's range of activities in its first year that combines the organization's three basic tenets (pillars): fundamental research, education and the exchange of information between academic and non-academic partners. Plans for the future are also indicated: improving the channels to disseminate knowledge and increase involvement of international researchers – by means of an active visitors program and international conferences –, an MSc program in the Economics and Financing of Aging that starts in September 2006, and the introduction of research themes. If you would like to receive a copy of the annual report, please contact the secretariat:

phone + (0)13 466 2109,  
e-mail [info@netspar.nl](mailto:info@netspar.nl)

A pdf file of the annual report is available on our website: [www.netspar.nl](http://www.netspar.nl)

## Kick-off events research themes

The coordinators of the three research themes 2006 each organize a kick off event for their theme. The first event, organized by Joost Driessen (*Valuation and Risk Management for Insurance Companies and Pension Funds*), takes place on November 2,

in Amsterdam. Peter Schotman (*Private Retirement Provision*) will launch his theme on November 23 in Maastricht and Maarten Lindeboom and Eddy van Doorslaer (*Income, Health and Work across the Life Cycle*) kick off on December 14.

## Transforming European Pension Systems, September 29 & 30, 2006, London.

*Research Conference CEPR and Netspar*  
The Centre for Economic Policy Research (CEPR) and Netspar are jointly organizing a conference with the principal objective of promoting research on the effect of the aging population in Europe, the transformation of the pension system and bringing together academics and practitioners in the field.

The main topics will be:

- Pension research in general
- Labor markets and pension decisions
- Pensions and financial markets
- New tools for studying pension system reform (eg surveys such as SHARE)

The program committee consists of Tito Boeri (University of Bocconi and CEPR), Monika Buetler (University of St. Gallen and CEPR) and Kees Koedijk (Erasmus University Rotterdam, CEPR and Netspar).

More information can be found on the website: [www.netspar.nl](http://www.netspar.nl)



## Netspar Calendar

September 14 – Netspar Pension Day (tentative)

September 29-30 – Conference 'Transforming European Pension Systems'

October 5 – Netspar Pension Day (tentative)

November 2 – Netspar Pension Day

November 23 – Netspar Pension Day

December 14 – Netspar Pension Day

January 2007 – ABP/VU/Netspar Pension Workshop

For more information please refer to our website.

