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CPB Netherlands Bureau for Economic Policy Analysis

Structural crisis?



Free Huizinga

Dark clouds seem to have gathered above the Dutch economy. Challenges such as the ageing of the population, the steady rise of low-wage countries and structural changes in agriculture and manufacturing sometimes lead to pessimistic or outright doom scenarios for the long-term future. The new CPB scenarios do not paint an unfavourable picture, however, for the long-term prospects of the Dutch economy. Despite these challenges, income per capita rises substantially in all

scenarios. How can this be explained?

To start, the Dutch economy, structurally, is not in such bad shape. The level of labour productivity per hour in the Netherlands is high – higher, for instance, than in the US. This has already been the case for thirty years. Despite the oil shocks in the seventies, the economic crisis in the eighties and the relatively slow productivity growth in the nineties, Dutch per capita GDP and real wages have grown by more than 60% since 1970. Apparently, the Dutch economy can stand some rough treatment.

In all scenarios, ageing limits the growth of labour supply and employment in the Netherlands. In other countries, however, ageing will strike even harder. In addition, the Dutch pension system has built up large reserves. As a result, Dutch tax and premium rates

need to rise less than in other countries, which boosts our competitive position, among other things. Furthermore, a rise in the labour force participation of especially older workers and women can counterbalance the effects of ageing.

Countries such as China and India will constitute a larger share of the world economy. Rather than posing a threat, this can present an opportunity. The growing level of production in those countries also increases the market for our exports, which in turn generates more trade. In the long run, this is favourable, although adjustments in the transition phase may be painful.

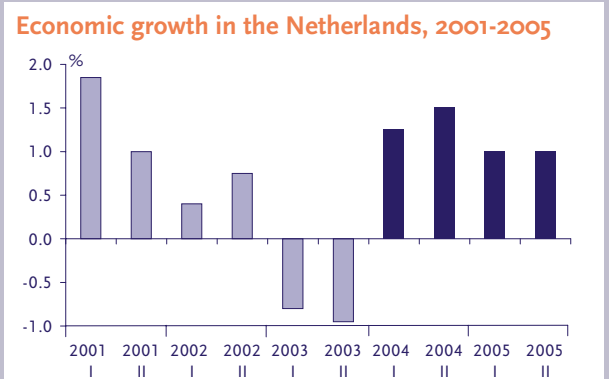
One of those adjustments concerns the sectoral structure. Parts of agriculture and manufacturing will get hurt, commercial services and health care will continue to grow – a shift that actually has been going on already for decades. The share of manufacturing in total employment, for instance, fell from almost 27% in 1950 to 15% in 2001. This has not resulted in a structural crisis. On the contrary, the market-enforced redeployment towards high-quality jobs has increased prosperity, without massive unemployment. Unemployment in the Netherlands was even extremely low at the end of the nineties, and is still low compared to the EU average. No reason for panic, therefore. Yet, external challenges do call for flexibility and adaptability, in the marketplace and in policy. History has shown that the Dutch economy can then flourish indeed. □

Free Huizinga, head of sector Growth, structure and knowledge economics

CPB's short-term forecasts December 2004

- In 2004, GDP in the Netherlands is expected to rise by 1½%. Economic growth will decelerate to 1% next year, mainly due to a further appreciation of the euro and higher oil prices.
- While exports and investments are rising, consumption growth is stagnating, mainly because of unfavourable developments in real disposable household income.
- Unemployment continues to rise steadily to 6¾% of the working population in 2005.

See the back page for the main economic indicators for the Dutch economy, or www.cpb.nl for more information.



^{a)} GDP volume growth rate compared to corresponding period in the previous year.

Recent publications

SEPTEMBER – DECEMBER 2004

The following list gives an overview of recent English-language CPB publications that have appeared between September and December 2004, ranked according to publication series. An abstract is included when studies are of particular relevance to the academic community or cover a topic interesting to international policymakers. All publications can be downloaded at www.cpb.nl. A press release on the publication is often also available from the website.

CPB Discussion Papers

39. Risk adjustment in the Netherlands: An analysis of insurers' health care expenditures

Rudy Douven, October 2004
More information:
r.c.m.h.douven@cpb.nl

As of 2006, the Dutch health care system will be run by regulated competition. An important part of regulated competition is a system of risk adjustment. This refers to the practice of paying insurers prospectively a subsidy per person that is related to the expected health care expenditures of that individual. This system levels the health care expenditure differentials between insurers that arise from differences in their population mix. This is important, since insurers must accept all enrollees for the same flat-rate premium. This paper presents an empirical analysis of the effects of risk adjustment in the Dutch social health insurance system covering the years 1991-2001. Results indicate that the risk-adjustment system has improved substantially. Whereas in the beginning of the nineties prospective risk adjustment could reduce the variation in health care expenditure differentials between insurers by about 20%, this figure rose to 55% in 2001.

40. Is the American Model Miss World? Choosing between the Anglo-Saxon model and a European-style alternative

Henri L.F. de Groot, Richard Nahuis and Paul J.G. Tang, October 2004
More information:
p.j.g.tang@cpb.nl

In Lisbon, the European Union has set itself the goal to become the most competitive economy in the world in 2010 without harming social cohesion and the environment. The motivation for introducing this target is the substantially higher GDP per capita of US citizens. The difference in income is mainly caused by the difference in the number of hours worked per employee. In terms of productivity per hour and employment per inhabitant, several European countries score equally well or even better than the United States, while at the same time they outperform the US with a more equal distribution of income. The European social models are at least as interesting as the US model that is often considered a role model. This study shows that income redistribution (through a social security system) does not necessarily lead to lower participation and higher unemployment, provided that countries supplement it with active labour market policies.

41. Refinement of the partial adjustment model using continuous-time econometrics

Arie ten Cate, November 2004
More information:
a.ten.cate@cpb.nl

CPB Documents

64. How much does a 30% emission reduction cost? Macroeconomic effects of post-Kyoto climate policy in 2020

Johannes Bollen, Ton Manders and Paul Veenendaal
More information:
p.j.j.veenendaal@cpb.nl

This study analyses the macroeconomic impacts of a climate policy that aims to reduce emissions of greenhouse gases by industrialised nations to 30% below the 1990 level. The economic consequences may vary widely. In 2020, the economic loss to the Netherlands is assessed as 0.8% of national income, provided that all countries implement the climate policy and that efficient international emission markets are in place. However, if the developing countries do not join the abatement coalition, and only industrialised nations are engaged in climate policy, the costs to the Netherlands may rise to 4.8% of national income. The costs also depend on economic growth in the underlying scenario. In a scenario with a global abatement coalition and moderate economic growth, these costs will amount to 0.2% of the national income.

66. Gas exploration and production at the Dutch Continental Shelf: An assessment of the 'Depreciation at Will'

Machiel Mulder, Arie ten Cate, Ali Aouragh and Joeri Gorter
More information:
m.mulder@cpb.nl

This report analyses the effects of Depreciation at Will (DAW) on offshore gas production, government budget and employment in the gas industry. The DAW enables firms to accelerate depreciation of investments in platforms and other offshore equipment. The interest advantage due to the postponed payments of taxes raises the profitability of investment projects and, hence, could raise the level of investments. The key question is whether the higher tax base compensates for the interest losses due to postponed tax receipts. The econometric analysis has shown that the DAW increased only the number of development drillings during the period this measure was implemented (1996-2002). In the current circumstances, re-introduction of the DAW will not raise the level of investments in the near future.

69. The free movement of services within the EU

Henk Kox, Arjan Lejour and Raymond Montizaan
More information:
h.l.m.kox@cpb.nl and
a.m.lejour@cpb.nl
See the article in this Newsletter.

What if we had a single EU market in services...?

Service firms in the European Union (EU) face many obstacles when attempting to export their services or set up a local affiliate in other EU member states. A single internal market for services, therefore, is still far away. Barriers to trade, which are mainly the result of national regulations, seem to hinder service firms more than manufacturing firms, as the service provider often has to deliver his service *in situ*, in the proximity of the foreign customers. When operating in other EU member states, these firms are confronted with a wide array of national regulations and red tape. Some countries require foreign firms to obtain special licenses to operate. In other cases, there are requirements for additional diplomas, local residence of management, or local professional insurance; there may also be constraints on the use of home country inputs, and restrictions on marketing, inter-firm cooperation, or the legal form of the company. Adding further to the trading costs of service providers are opaque regulations, a multiplicity of regulatory agencies, and fuzzy implementation procedures. Is it any wonder, then, that intra-EU trade in commercial services represents a mere 2 percent of GDP in the European Union, even though the sector produces more than half of the EU's GDP?

Not regulation as such, but particularly the heterogeneity of regulations across member states causes additional trade costs. The qualification costs that a service firm incurs in each subsequent export market are in most cases fixed and sunk market entry costs. Characteristic for the present situation is also that qualification costs incurred by a firm in one market are forfeit when the firm enters the market of another country. Such fixed costs often are independent of firm size, implying that small- and medium-sized firms carry the heaviest burden of policy heterogeneity.

The European Commission recently introduced proposals to bolster the internal market in services. A key element is the 'country of origin' principle. After having complied with the regulations in the country of origin, an EU service provider may – apart from some explicit exceptions – no longer be confronted with additional regulations in the member state where the service is delivered. It means, essentially, that member states mutually recognise each other's regulation regime. The proposals apply to an extensive part of the EU services sector, and contain other elements that will reduce trade and investment costs for services firms.

CPB's recently published study, *The free movement of services within the EU*, investigates how cross-border trade and foreign direct investment in commercial services will change if the EU directive is fully implemented. Using the OECD International Regulation database, Henk Kox, Arjan Lejour and Raymond Montizaan constructed an indicator of bilateral heterogeneity in product-market regulation for all EU country pairs. The heterogeneity indicator is based on some 200 regulatory items, and can be disaggregated into five different sub-domains of regulation. Applying the indicator in a gravity model, the CPB researchers discovered a significant negative impact on both bilateral commercial services trade and on bilateral FDI between EU member states. Stated positively, countries with more similar product market regulations



have more bilateral trade and direct investment in services. The regression results are used for quantifying the effects of the new EU proposals. Through a detailed assessment of accordance between the EU directive and the OECD regulatory items, the researchers have estimated the structural impact of the measures on bilateral policy heterogeneity. The upshot is that full implementation will remove much of the heterogeneity in regulation. Intra-EU trade for commercial services could increase by 15-30% on average. Total intra-EU trade (including goods trade) would then increase by 1 - 3%. The bandwidth in results reflects both statistical uncertainties and the uncertainties regarding the final implementation form of the EU proposals. The largest effects will be experienced by countries that now face a great deal of regulation heterogeneity, relatively speaking, with their partner countries. The impacts of the EU proposals on intra-EU FDI stocks are analysed in the same way. The study finds an average increase in bilateral direct investment stocks by 20 to 35%, mainly caused by less heterogeneity in barriers to competition and fewer FDI restrictions. The EU proposals thus appear to be a promising track leading to a single internal market in services. □

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CPB Newsletter is a publication of CPB Netherlands Bureau for Economic Policy Analysis
P.O. Box 80510
2508 GM The Hague
The Netherlands
T +31 70 3383380
F +31 70 3383350
I www.cpb.nl

Editorial board:

Taco van Hoek, editor in chief
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Jacqueline Timmerhuis
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Print: Koninklijke De Swart
Design: Maarten Balyon
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Main Economic Indicators for the Netherlands, 2002-2005

	2002	2003	2004	2005 ^{a)}
	annual growth rates %			
International items				
Relevant world trade volume	2.2	4.3	7 ½	6 ¼
Import price goods	-1.7	-1.2	1 ¼	0
Export price competitors	-3.3	-4.8	-1 ½	-1
Crude oil price (Brent, level in dollars per barrel)	25.0	28.9	39	40 ½
Exchange rate (dollar per euro)	0.94	1.13	1.24	1.30
Unit labour costs competitors in manufacturing	-1.7	-5.6	-3 ¼	-1 ½
Demand and output (volume)				
Gross domestic product (GDP, economic growth)	0.6	-0.9	1 ½	1
Private consumption	1.3	-0.9	½	-¼
Gross fixed investment, private non-residential	-6.4	-3.5	1 ½	2 ¼
Private residential investment	-4.4	-4.2	1 ¾	3
Exports of goods (non-energy)	0.9	0.5	7 ¼	4 ¾
of which domestically produced	1.8	-0.8	2 ¾	1 ½
re-exports	-0.3	2.2	13 ¼	8 ¾
Imports of goods	-0.2	1.0	6 ½	4
Production market sector ^{b)}	-0.6	-1.3	1 ½	1
Prices and wages				
Consumer price index (CPI)	3.4	2.1	1 ¼	1 ¼
Price domestic expenditure	3.3	2.7	1 ¼	1
Export price goods (excluding energy)	-1.0	-0.6	0	-¼
Contractual wages market sector	3.5	2.7	1 ½	¾
Compensation per employee market sector	6.6	3.8	2 ½	½ (1)
Unit labour costs in manufacturing	4.5	3.4	-2 ¼	-¼
Labour market				
Unemployment rate (level in % of labour force)	4.0	5.1	6 ¼	6 ¾
Unemployment (x 1000)	302	396	480	525
Employment (labour years)	-0.1	-1.0	-1	¼ (-¼)
Employment (> 12 hours/week)	-0.1	-0.5	-¾	½ (0)
Labour force (persons)	0.6	0.8	½	1 (¾)
Public sector				
General government financial balance (level in % of GDP)	-1.9	-3.2	-3	-2 ¼
Gross debt general government (level in % of GDP)	52.6	54.1	56	58 ½
Taxes and social security contributions (level in % of GDP)	39.4	39.3	39	39 ¼
Miscellaneous items				
Purchasing power	0.6	-1.2	-¼	-1 ¼
Household disposable income	4.3	0.8	2	0
Labour productivity market sector ^{b)}	0.6	0.8	3 ½	1 ¼ (1 ½)
Price gross value added market sector ^{b)}	3.9	2.3	¼	0
Real labour costs market sector ^{b)}	2.5	1.4	2 ¼	½
Labour share in enterprise income market sector ^{b)} (level in %)	85.3	86.9	86 ¼	86 ½
Export surplus (level in % of GDP)	5.1	5.0	5 ½	5 ¾
Long-term interest rate (level in %)	4.9	4.1	4 ¼	4 ¼
Short-term interest rate (level in %)	3.3	2.3	2	2

^{a)} Figures between brackets have been adjusted for statistical effects related to institutional reforms in sickness and disability insurance.

^{b)} Excluding mining and quarrying and real estate activities.