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# CPB Newsletter

2004 June 1

CPB Netherlands Bureau for Economic Policy Analyses

Henk Don

## Introduction

It is a pleasure to introduce the first issue of CPB Newsletter - in some way a successor to CPB Report. This newsletter provides, among other things, information on the most recent economic forecasts and on our latest publications. We will publish this newsletter on a quarterly basis. Of course, we hope this will entice you to take a closer look at our work. At www.cpb.nl you can download all our publications and find additional information on CPB and its work programme. As CPB studies many different topics - such as competition issues, health care, education and innovation, international trade and business cycles - we trust that you will always find something that fits your interest.
The newsletter is targeted at the scientific community and economists interested in Dutch and international issues. A somewhat more elaborate Dutch version of this Newsletter is published simultaneously, and both newsletters are also available at www.cpb.nl.

Henk Don, director

## Wage moderation

Wage moderation has been a constant factor in the Dutch debate about employment policies since the Wassenaar agreement of 1982. The benefits of wage moderation in terms of reducing unemployment are undisputed. Some economists argue, however, that wage moderation also causes a structural slowdown of productivity growth, for instance by allowing marginal firms with low profits and little innovation to remain in existence. In their view, the Dutch policy focus on wage moderation is, therefore, short-sighted. Instead, they argue for a wage push to raise productivity growth.

In the recent publication 'Wage Moderation and Labour Productivity', CPB researchers Peter Broer and Frederik Huizinga study the effects which can be expected of a wage push. Initially, labour productivity rises. Firms respond to the wage push by substituting capital for labour and by focussing on innovations that save on labour instead of on capital. However, this rise in labour productivity is inefficient and temporary. The mirror image is that – due to the high wage costs – unemployment rises. Moreover, the return to capital of firms has fallen below international levels. Investments drop and unemployment rises further, until wages fall back to their equilibrium level. At that point firm profits are back to normal, and investment and the capital-labour ratio return to their normal levels as well.

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## CPB's short-term forecasts June 2004

- In both 2004 and 2005, GDP in the Netherlands is expected to rise by 1¼%.
- Unemployment will continue to rise rapidly, to 7¼% of the labour force next year.
- This year, the general government (EMU) deficit is projected at 3.0% of GDP, declining to 2.7% of GDP next year.

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

**Economic growth in the Netherlands, 2001-2005 a)**


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

# Recent publications

MARCH – JUNE 2004

*The following list gives a complete overview of recent CPB-publications that have appeared between March and June 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. The publications can be downloaded at www.cpb.nl. A press release on the publication is often also available from the website.*

## Forecasts

### *Central Economic Plan 2004 (only in Dutch)*

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The CEP 2004 describes the situation for the Dutch and international economy, and presents forecasts for the economic development in 2004 and 2005. Special topics in this CEP are 'The German economy from a Dutch viewpoint' and 'Abolishment of tax advantages of prepension schemes: Effects on labour supply'.

## CPB Discussion Papers

### *28. Wage moderation and labour productivity*

Frederik Huizinga and Peter Broer, March 2004
More information:
huizinga@cpb.nl

See this issue for a summary.

### *29. An efficient method for detecting redundant feedback vertices*

Berend Hasselman, March 2004
More information:
douven@cpb.nl

### *30. Pharmaceutical promotion and GP prescription behaviour*

Frank Windmeier et al., Eric de Laat, Rudy Douven and Esther Mot, April 2004
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douven@cpb.nl

*>Wage moderation (continued)*

Unemployment at this point is still high, however. Unemployment can only return to its original level if the cause for the wage push, such as a rise in taxes, replacement rates or union militancy is also reversed. In that case wages and labour productivity growth will temporarily fall below equilibrium as the economy reabsorbs the unemployed. Low wage costs reduce the capital-labour ratio and firms now focus on capital saving innovations.

What is the net effect on the level of labour productivity? At a first approximation, nothing. In the long run wages and the capital-labour ratio return to normal. However, the shift in focus from labour saving to capital saving techniques is dynamically inefficient. In addition, a wage push slows down the overall process of technological adoption. A wage push reduces the profitability of investment in general, also the investment in new technology.

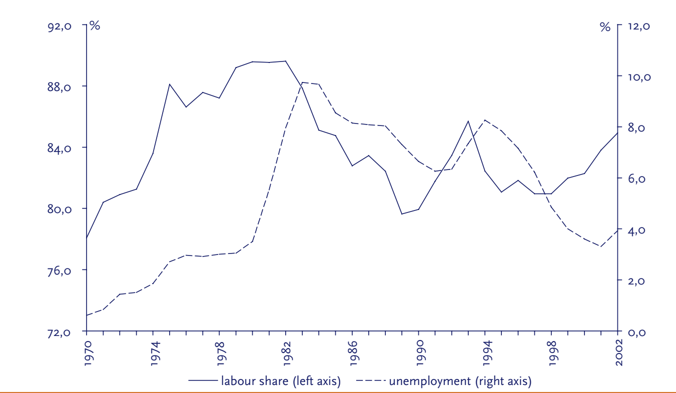
What if innovation is hampered by a lack of competition? Can cost pressure force firms to innovate in the absence of competitive pressure from other firms? Probably not. With insufficient competition, firms will be able to pass on wage increases in the form of higher output prices. Thus increasing cost pressure only leads to more inflation. If innovation is reduced because of insufficient competition, the proper instrument is an effective competition policy, not a general wage increase.

A wage push, therefore, generally hurts labour productivity in the long run. However, wage levels below equilibrium are inefficient as well, leading to labour shortages and inefficient operation of firms. In addition, the low unemployment raises union wage demands. The rise in wages in this case is initially efficient. However, experience has taught that such a rise in wages may well overshoot, leading to wages that are too high and, consequently, to a rise in unemployment.

These theoretical insights match the Dutch experience well. The figure below shows the development of unemployment and the labour income share in the Netherlands. In the 1960's Dutch wages rose quickly. This was justified by low unemployment and rapid technological progress. In the 1970's Dutch productivity levels matched the US levels and technological progress slowed down. The rise in wages continued, however. Labour productivity growth initially remained high, but dropped sharply at the end of the 1970's, much more than in other European countries. Consequently, the labour-income share also rose.

The gain in productivity that the Netherlands had made in the previous ten years relative to those countries was more than reversed in the following five years. The wage push in the 1970's, therefore, unintentionally demonstrated that high wages in the end do not raise productivity. The wage push ended in the deep recession with high unemployment rates in the early 1980's. The wage moderation that followed led to economic recovery and a very fast employment growth in the 1990's. At the end of the 1990's unemployment has fallen to very low levels and labour market shortages were widespread. With hindsight, one can say that wage moderation had overshot. The wage increase that followed was initially justified, but overshot, leading to a rapid deterioration of competitiveness and a rapid rise in unemployment.

At this moment, wage moderation is the appropriate means to restore economic growth. Once economic recovery has been reached, the challenge is to gear wage growth to maintaining equilibrium in the labour market. This will be helpful in pursuing a steady growth of labour productivity, in addition to an effective competition policy.



What are the responses by general practitioners to promotional activities for pharmaceuticals by pharmaceutical companies? Panel data estimations show that the doctors' drug price elasticity is small. The effect of promotion on the price elasticity is negative: more promotion reduces the price sensitivity of the general practitioners. This effect reduces welfare, and can lead to increased costs for pharmaceuticals.

### *31. Explaining the growth of part-time employment; Factors of supply and demand*
Rob Euwals and Maurice Hogerbrugge, April 2004
More information:
euwals@cpb.nl

### *32. A leading indicator for the Dutch economy, Methodological and empirical revision of the CPB system*
Henk Kranendonk, Jan Bonenkamp and Johan Verbruggen, June 2004
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Since 1990, CPB Netherlands Bureau for Economic Policy Analysis (CPB) has used a leading indicator in preparing short-term forecasts for the Dutch economy. This paper describes some recent methodological innovations as well as the current structure and empirical results of the revised CPB leading indicator. The revised system, which uses 25 different basic series, performs quite well in describing the economic cycle of GDP, and in telling the story behind the business cycle.

## CPB Documents

### *54. A snapshot of the AWBZ: An analysis of strengths and weaknesses*
Rudy Douven, Esther Mot and Kees Folmer, March 2004 (only in Dutch)
More information: mot@cpb.nl

### *55. The Dutch ICT-industry and multinationals; The relationship between performances and competences*
Bert Minne and Henry van der Wiel, March 2004 (only in Dutch)
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### *56. Assessing the economic implications of Turkish accession to the EU*
Arjan Lejour, Ruud de Mooij and Clem Capel, March 2004
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What are the economic implications of the possible Turkish accession to the European Union? Overall, the macroeconomic implications for EU countries are small but positive. This is caused by cheaper imports and the benefits from trade creation. Turkey experiences larger economic gains than the EU: consumption per capita is estimated to rise by about 4% as a result of accession to the internal market and free movement of labour. If Turkey would succeed in reforming its domestic institutions in response to EU-membership, the economic benefits could be even larger. These benefits would spill over to the rest of Europe.

### *57. Second opinion global cost benefit analyses urbanisation Randstad and infrastructure Haarlemmermeer – Almere*
Annemiek Verrips, Paul Besseling et al., April 2004 (only in Dutch)
More information:
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### *58. Incentives for technology transfer institutes*
Maarten Cornet and Jeroen van de Ven, April 2004
More information:
cornet@cpb.nl

### *59. Can labour market institutions explain unemployment rates in new EU member states?*
Sjef Ederveen and Laura Thissen, April 2004
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In five out of ten new member states, unemployment rates lie above average unemployment in the fifteen 'old' members of the European Union (EU-15). Inflexible labour market institutions are often held responsible for high unemployment. If so, reforming labour market institutions could provide the solution. However, in the new EU member states, reforming labour market institutions will not have a large effect on labour market performance, since labour market institutions in these countries are found to be less rigid than in the EU-15. The main reasons for high unemployment in Poland and the Slovak Republic are probably more related to postponed restructuring in combination with tight monetary policy, and poor governance.

## Special Publications

### *52. Four futures for energy markets and climate change*
Johannes Bollen, Ton Manders and Machiel Mulder, April 2004
More information:
mulder@cpb.nl

Future developments in energy and climate are highly uncertain. In order to deal with these uncertainties, CPB developed four long-term scenarios based on the recently published economic scenarios Four Futures of Europe. In the next decades, global reserves of oil and natural gas will likely be sufficient to meet the growing demand. Therefore, a looming depletion of natural energy resources is not to be expected. The use of fossil energy carriers will, however, affect climate because of the emissions of greenhouse gasses. In order to mitigate global increases of temperature, emissions of greenhouse gasses will have to be reduced.

## *Colofon*

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## Main Economic Indicators for the Netherlands, 2002-2005

| | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|
| annual growth rates % | | | | |
| **International items** | | | | |
| Relevant wordl trade volume | 2.0 | 4.3 | 7 | 7 |
| Import price goods | –1.2 | –1.4 | 1 | ½ |
| Export price competitors | –3.1 | –5.0 | – ½ | ¾ |
| Crude oil price (Brent, level in $ per barrel) | 25.0 | 28.9 | 34 | 32 |
| Exchange rate (dollar per euro) | 0.94 | 1.13 | 1.21 | 1.20 |
| Unit labour costs competitors in manufacturing | –1.0 | –5.3 | – 4 | 0 |
| **Wages and prices** | | | | |
| Contractual wages market sector | 3.5 | 2.7 | 1 ¼ | ¾ |
| Compensation per employee market sector | 5.0 | 4.8 | 2 ¼ | ¼ |
| Unit labour costs in manufacturing | 4.6 | 2.4 | – 2 | –1 ¼ |
| Export price goods (excluding energy) | –0.6 | –1.0 | 0 | ¼ |
| Consumer price index (CPI) | 3.4 | 2.1 | 1 ½ | 1 ¼ |
| Price domestic expenditure | 3.7 | 2.4 | 1 ¼ | 1 |
| **Demand and output (volume)** | | | | |
| Private consumption | 0.8 | –1.2 | ¾ | 0 |
| Gross fixed investment, private non-residential | –5.9 | –3.6 | 0 | 1 |
| Private residential investment | –3.7 | –0.8 | 3 ½ | 3 ¾ |
| Exports of goods (non-energy) | 0.0 | 0.5 | 5 ½ | 7 ¼ |
| of which domestically produced | 0.6 | –0.9 | 1 ¾ | 2 ¾ |
| re-exports | –0.7 | 2.3 | 10 ¼ | 12 ½ |
| Imports of goods | –1.1 | 1.1 | 5 | 5 ¾ |
| Production market sector [a)] | –0.7 | –1.6 | 1 ½ | 1 ¾ |
| Gross domestic product (GDP) | 0.2 | –0.7 | 1 ¼ | 1 ¼ |
| **Labour market** | | | | |
| Employment (labour years) | 0.2 | –1.0 | –1 ¼ | ½ |
| Employment (persons working 12 hours or more) | 0.8 | –0.4 | –1 | ¾ |
| Labour force (persons) | 1.4 | 0.8 | ¾ | 1 ¼ |
| Unemployment rate (level in % of labour force) | 3.9 | 5.1 | 6 ¾ | 7 ¼ |
| **Public sector** | | | | |
| General government financial balance (level in % of GDP) | –1.6 | –3.2 | – 3 | –2 ¾ |
| Gross debt general government (level in % of GDP) | 52.4 | 54.7 | 55 ¾ | 57 ½ |
| Taxes and social security contributions (level in % of GDP) | 39.5 | 39.4 | 39 | 39 |
| **Miscellaneous items** | | | | |
| Purchasing power (median of all households) | 0.7 | –1.1 | – ½ | –1 ¼ |
| Household disposable income | 4.1 | 2.1 | 2 ¼ | 1 ¼ |
| Labour productivity market sector [a)] | 0.1 | 0.6 | 3 ¾ | 1 ½ |
| Price gross value added market sector [a)] | 4.1 | 2.3 | ½ | ¼ |
| Real labour costs market sector [a)] | 0.8 | 2.4 | 1 ¾ | – ¼ |
| Labour share in enterprise income (level in %) | 85.0 | 87.5 | 86 ½ | 86 |
| Export surplus (level in % of GDP) | 5.1 | 5.3 | 5 ½ | 5 ½ |
| Long-term interest rate (level in %) | 4.9 | 4.1 | 4 ¼ | 4 ¾ |
| Short-term interest rate (level in %) | 3.3 | 2.3 | 2 | 2 ¼ |

[a)] excluding mining and quarrying and real estate activities