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Creativity and perseverance in market regulation



Paul de Bijl

A vision of the ideal world in the future is good, but how getting there also matters. Thus, a new health care system may seem promising on paper but implementing it is another matter. However, the good news is that a successful transition provides credibility. Governments cannot afford to neglect this aspect.

We need to learn from the difficulties of previous experiences. When privatization and liberalization were launched in the 1980s and 1990s, the claim was made that the private sector and markets were superior to the public sector – more efficient and more innovative. This analysis was too simple, which is why we were not spared a few blunders. Territorial battles ensued between taxi-drivers. Lesson: pay due attention to those who have something to lose. NS (Dutch Railways) threw up obstacles for the newcomer Lovers Rail. Lesson: design details have a big impact on behaviour. Having said that, there is much that has gone well in the introduction of market forces. Consumers are benefiting. Nevertheless, we should be looking for areas for improvement.

An example will illustrate these areas. Imagine the taxi market is completely closed and you want to deregulate in order to encourage newcomers, thereby creating increased competition and a more dynamic market. If you get rid of the limits on the number of licences in one go – so that the licences lose their tradability – you are disregarding the fact that entrepreneurs in the taxi business had paid large sums for these licences in the past. It is only to be expected that they dig

their heels in. You can promise them compensation, but what amount, and can you deliver on this? An alternative is to maintain the trade in licences while gradually lowering barriers to entry. Talented newcomers can take over businesses that are stuck in the past. That is good for the dynamic efficiency in the market. Established businesses will still be able to realise the cash value of their licences. Deregulation is thus easier to digest – even though there is an increase in competition! The crux of this idea, which is taken from Francesco Caselli and Nicola Gennaioli (*Quarterly Journal of Economics*, August 2008), is the synergy with the associated market in tradable rights. This creates a lever to reduce resistance among players with vested interests. Compensation (and the amount) is decided upon by negotiations between entrepreneurs. Endogenously, as economists would put it. In this way, the government avoids the problem that it is difficult and expensive for a government to determine appropriate compensation, while the result often lacks credibility.

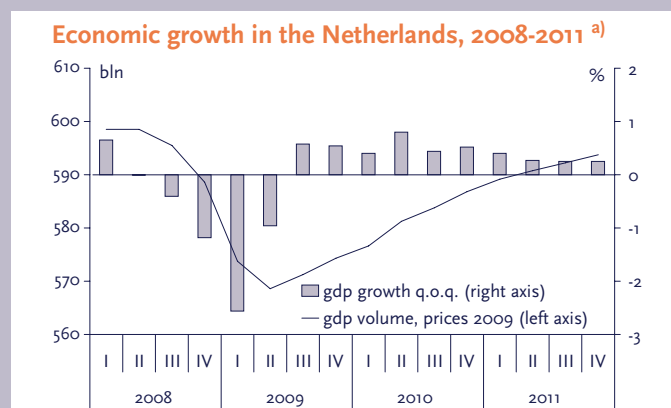
Thus, the success of market regulation policy depends crucially on how obstacles and resistance are tackled. Economists can come up with new ideas on how to initiate and maintain change processes. Nothing signifies credibility more powerfully than bringing an awkward, lengthy project to a successful conclusion. That gives a welcome bonus at a time when confidence in governments appears under pressure while expectations are rising, ranging from the quality of public services to safeguarding public interests in health care and keeping the financial sector afloat. That is quite a challenge. The future requires both creativity and perseverance. □

Paul de Bijl, head of sector Competition and regulation

CPB's short-term forecasts September 2010

- The Dutch economy is expected to grow by 1¾% in 2010. Next year, GDP growth decelerates somewhat, to 1½%.
- The estimated average unemployment rate rises to 5½% of the labour force in 2010 and remains at that level next year.
- Inflation is expected to rise to 1¼% in 2010 and 1½% in 2011. Contractual wage growth in the market sector will come out at 1% and 1½% respectively.
- Purchasing power of households (median) declines by ½% this year and by ¼% next year.
- The government budget deficit will be 5.8% GDP this year. The deficit will decrease to 3.9% GDP in 2011.

For the main economic indicators for the Dutch economy, see the back page or www.cpb.nl.



^{a)} GDP volume growth rate compared to previous period.

Recent Publications

JUNE 2010 - SEPTEMBER 2010

The following list provides an overview of recent CPB publications that have appeared in English between June and September 2010. All publications can be downloaded at www.cpb.nl. An English press release on these publications is sometimes available on the website.

Forecasts

Macro Economic Outlook 2011 (MEV, only in Dutch)

johan.verbruggen@cpb.nl

The *Macro Economic Outlook (MEV) 2011* describes the situation for the Dutch economy and the international economy, and presents forecasts for economic developments in 2010 and 2011.

CPB Documents

210. Systemic risk in the financial sector; a review and synthesis

Michiel Bijlsma, Jeroen Klomp and Sijmen Duineveld, July 2010
michiel.bijlsma@cpb.nl

The financial crisis has put systemic risk firmly on the policy agenda. In such a crisis, an initial shock gets amplified as it propagates to other financial intermediaries, ultimately disrupting the financial sector. This paper reviews the literature on such amplification mechanisms, which create externalities from risk taking. The authors distinguish between two classes of mechanisms: contagion within the financial sector and pro-cyclical connection between the financial sector and the real economy.

CPB Discussion Papers

152. Health insurance competition; the effect of group contracts

Jan Boone, Rudy Douven, Carline Droge and Ilaria Mosca, June 2010
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Health insurance in countries like the US and the Netherlands is provided by private firms. These firms can offer both individual and group contracts. The strategic and welfare implications of such group contracts are not well understood. The authors estimate a model in order to determine which factors explain the price of group contracts. They find that groups that are located close to an insurers' home turf pay a higher premium than other groups.

153. Regulatory legacy, VoIP adoption and investment incentives

Paul de Bijl and Martin Peitz, June 2010
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This paper explores the effects of access regulation of PSTN telephony networks on consumer adoption of a new technology in the form of 'Voice over Internet Protocol' (VoIP). It also discusses the link between access regulation and the incentives to invest in VoIP.

154. The effects of a change in market abuse regulation on abnormal returns and volumes; evidence from the Amsterdam stock market

Tyas Prevoo and Bas ter Weel, July 2010
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The Market Abuse Directive came into effect on October 1st, 2005. This legislation aims to reduce illegal insider trading and leakage of information prior to official releases by increasing penalties. This paper reveals that the information value of announcements, measured by the announcement day abnormal return and abnormal volume, is not significantly different after the new regulation than it was before, although the number of press releases has increased significantly.

155. Analyzing female labor supply: Evidence from a Dutch tax reform

Nicole Bosch and Bas van der Klaauw, August 2010
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See the article on page 3 of this issue of *CPB Newsletter*.

156. A meta-analysis of the equity premium

Casper van Ewijk, Henri de Groot and Coos Santing, August 2010
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The equity premium is a key parameter in asset allocation policies. There is a vigorous debate in the literature regarding the actual measurement of the equity premium, its size and the determinants of its variation. This study identifies how the size of the equity premium depends on the way it is measured, along with its evolution over time

and its variation across regions in the world. The authors find that the equity premium is significantly lower if measured by ex ante methods rather than ex post, in more recent periods, and for more developed countries.

157. The effect of competition on process- and outcome quality of hospital care. An empirical analysis for the Netherlands

Michiel Bijlsma, Pierre Koning, Victoria Shestalova and Ali Aouragh, September 2010
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This paper focuses on the relationship between competition and quality in the Dutch hospital sector. The authors analyse the period 2004-2008, in which a healthcare reform took place in the Netherlands, introducing competition in the healthcare sector. The study shows that competition explains differences in performance on process indicators (e.g. share of operations cancelled within 24 hours before the operation), but not on outcome indicators (e.g. mortality rates).

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More working women due to tax reform

The Dutch tax reform of 2001 has increased after-tax wages substantially. Contrary to earlier research, this study finds that women have not raised their number of working hours. At the same time, it must be noted that more women have started to work. Overall, female labour supply has increased by about 2%.

Female labour-force participation

Labour-force participation of Dutch women is above average within the OECD, but their share of part-time employment is by far the highest. About 60% of all working women in the Netherlands work less than 30 hours per week. Previous research indicates that part-time work is persistent. Whereas part-time work used to be seen as beneficial to increase low female participation rates, nowadays more attention is paid to the drawbacks. Women who work part-time are paid less and have fewer promotion prospects. Furthermore, stimulating women to work more (hours) enhances economic growth and contributes to efforts to deal with the costs of an ageing population.

Making work pay more

It is generally believed that female labour-force participation is responsive to financial incentives. Indeed, one of the motivations of the tax reform of 2001 was to make work financially more attractive for women. The tax reform consisted of two main elements. The first of these was a reduction in marginal tax rates, thereby increasing after-tax hourly wages. As shown in figure 1, the magnitude of this reduction differed substantially among income levels. The second element was the removal of some perverse incentives of tax allowances by replacing them with tax credits.

Tax allowances and tax credits are both transferable between partners, but have different effects. Both arrangements reduce the incentives for non-working women to start working. The difference between the two (in terms of after-tax income) lies in whether or not the income of the partner matters. Whereas a tax credit is simply a reduction in the total amount of taxes that an individual



should pay, the benefit of the tax allowance depends on the marginal tax rate of the partner. Prior to the tax reform, it was less profitable for a non-working woman to start working if the partner had a high income. The reason was that when working, women had to use their own allowance at a low marginal tax rate, while when not working it would be transferred to their partner with a higher marginal tax rate. The tax reform changed the allowance into a tax credit, which reduced the fixed costs of working. Figure 2 shows the increase in after-tax income at two income levels.

Working hours

The study's findings indicate that the Dutch tax reform increased female labour-force participation by about 2.4 percentage points. This rise can be attributed mainly to the shift from the tax allowance to the tax credit. The effect of diminishing marginal tax rates is small and insignificant. Women have slightly reduced their number of working hours in response to higher after-tax hourly wages. Overall, the tax reform increased the average of weekly working hours by 0.4, which is about 2% of the average female working week. □

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Figure 1 Marginal tax rates before and after the tax reform of 2001

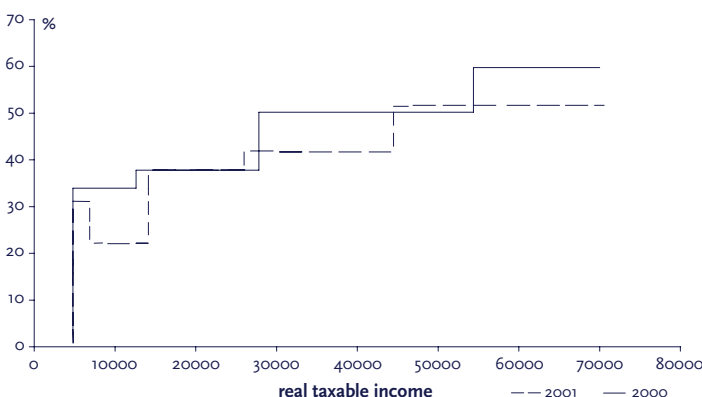


Figure 2 Change in after-tax household income due to tax reform of 2001



Main Economic Indicators for the Netherlands, 2008-2011

	2008	2009	2010	2011
	annual growth rates %			
International items				
Relevant world trade volume	1.6	- 12.6	9	5¼
Import price goods	4.6	- 7.5	6¾	¾
Export price competitors	3.9	- 3.0	4	¾
Crude oil price (Brent, level in \$ per barrel)	96.9	61.5	76	75
Exchange rate (dollar per euro)	1.47	1.39	1.29	1.25
Long-term interest rate (level in %)	4.3	3.7	3¼	3¾
Demand and foreign trade (volume)				
Gross domestic product (GDP)	1.9	- 3.9	1¾	1½
Private consumption	1.1	- 2.5	½	¾
Public demand	3.0	4.0	½	- ¼
Gross fixed investment, private non-residential	7.1	- 18.2	- 5½	2¾
Exports of goods (non-energy)	1.2	- 9.2	12¾	7½
of which domestically produced	- 1.4	- 10.5	8¼	3
re-exports	3.8	- 7.9	16¾	11¼
Imports of goods	3.3	- 10.3	11¼	6
Wages, prices and purchasing power				
Export price goods (excluding energy)	2.1	- 5.3	4¾	¾
Price competitiveness ^{a)}	- 0.1	4.2	- 2	¼
Consumer price index (CPI)	2.5	1.2	1¼	1½
Contractual wages market sector	3.5	2.7	1	1½
Compensation per full-time employee market sector	3.5	2.0	2	3
Purchasing power	0.0	1.8	- ½	- ¼
Labour market				
Labour force (persons)	1.9	0.6	- ½	- ¼
Employment (persons > 12 hours/week)	2.6	- 0.4	- 1¼	- ¼
Unemployment rate (level in % of labour force)	3.8	4.8	5½	5½
Unemployment (level in 1000 persons)	300	377	435	435
Market sector ^{b)}				
Production	1.7	- 5.4	1¾	2
Labour productivity	0.5	- 3.1	4¼	2¼
Employment (labour years)	1.2	- 2.4	- 2¼	- ¼
Price gross value added	0.7	2.6	2¼	1
Real labour costs	2.8	- 0.6	0	2
	levels in %			
Labour share in enterprise income	79.0	80.9	77¼	76¾
Profit share (of domestic production) ^{c)}	13.8	7.7	11¾	13½
Public sector				
General government financial balance (% GDP)	0.6	- 5.4	- 5.8	- 3.9
Gross debt general government (% GDP)	58.2	60.8	64.5	66.2
Taxes and social security contributions (% GDP)	39.1	38.2	37.9	38.5

^{a)} Export price competitors minus export price domestically produced goods.

^{b)} Private sector excluding health care, mining and quarrying, and real estate.

^{c)} Market sector excluding banking and insurance companies.