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# CPB Newsletter

2007 December 4

CPB Netherlands Bureau for Economic Policy Analysis


## The world economy does not matter

Wim Suyker

When it rains in Germany, it drizzles in the Netherlands. There are many such clichés about the dependence of the Dutch economy on the rest of the world. What's more: they're all true and easy to illustrate with facts. For instance, the correlation between annual growth rates of GDP of the Netherlands and the euro area is extremely high (a correlation coefficient of 0.8 in the past 35 years). A rise in euro-area inflation of 1 percentage point is usually accompanied by a rise in Dutch inflation of 1 percentage point. And differences between long-term interest rates are only visible when expressed in hundredths of percent. If the CPB could forecast the world economy perfectly – which is, unfortunately, not the case – then making the forecast of the Dutch economy would be a piece of cake. The strong relationship is not only cyclical in nature; it's structural as well. In the past 35 years, annual economic growth in the Netherlands and in the euro area was 2.6% and 2.4%, respectively. This is a tiny difference, particularly compared with the much higher economic growth rates seen in dynamic Asia.

While all of these clichés are correct, they are also irrelevant. Why is this? In the first place, performing equally well as the rest of the world does not come for free. Dutch firms have to make an effort to secure export orders – not only in emerging economies like China and India, but also in 'easy' European markets. Productivity gains are not like manna from heaven. In order to raise productivity, Dutch firms have to invest and innovate, while employees have to train and learn. The Dutch government cannot lean back, either. To reach the same results as elsewhere, equivalent policy efforts are often required.

The second reason why the world economy in itself is irrelevant relates to political economy: it is the relative economic performance of the Netherlands that matters. Sunshine in the Netherlands matters only when it rains elsewhere. The opposite situation – a less favourable economic development in the Netherlands than elsewhere – matters even more. A prime example of the latter can be found in the '70s, when Dutch economic growth was much lower than elsewhere, and both unemployment and the government budget were deteriorating more sharply. A distinct example of the opposite can be seen in the '90s, when foreigners were flooding the country to study the 'Dutch economic miracle'. Unfortunately, this heyday was quickly followed by several years of relatively weak economic performance.

Economic developments abroad have a considerable short-term impact on the Dutch economy. At the end of the day, however, a good economic performance at home depends upon our own efforts. Our motto is thus, get to work!

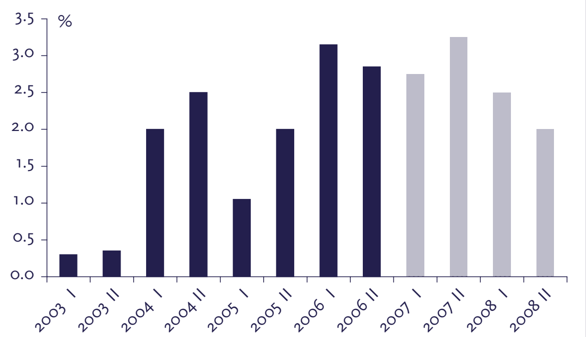
*Wim Suyker, programme leader International Cyclical Analysis*

## CPB's short-term forecasts December 2007

- Dutch economic growth is expected to be 3% in 2007, but will drop back to 2¼% in 2008.
- Production growth in the private sector will halve, from 4% this year to 2% next year.
- Tensions in the labour market are increasing. The unemployment rate will continue to fall, to 4% in 2008.
- Contractual wage growth is accelerating to 3¼% in 2008. Inflation is rising gradually, to 2¼% in 2008.
- The government budget is in balance this year, but shows a surplus of 0.5% GDP next year.

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

Economic growth in the Netherlands, 2003-2008 [a)]




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

# Recent Publications

## September 2007 – December 2007

*The following list provides an overview of recent CPB publications that have appeared in English between September and December 2007. All publications can be downloaded at www.cpb.nl. An English press release on these publications is sometimes available at the website.*

## CPB Documents

### *153. Immigration policy and welfare state design; a qualitative approach to explore the interaction*

Victoria Chorny, Rob Euwals and Kees Folmer, October 2007
*rob.euwals@cpb.nl*

This study confronts three possible labour migration regimes - a temporary, an open and a selective regime - with two possible welfare state settings - a highly redistributive and a hardly redistributive welfare state. The conclusions are: (i) both labour migration policy and the welfare state matter for the skill composition of labour migrants; (ii) to be attractive for high-skilled labour migrants a highly distributive welfare state needs to undo its discouraging effect on these migrants; and (iii) a highly redistributive welfare state is attractive for low-skilled labour migrants. Low-skilled migrants may become costly for such a welfare state once they manage to stay permanently. If the Cabinet opts for a temporary migration policy for the low-skilled, this has to be designed carefully in order to ensure this migration does not turn out to be permanent in the end.

### *154. The economic effects of Croatia's accession to the EU*

Arjan Lejour, Andrea Mervar and Gerard Verweij, October 2007
*arjan.lejour@cpb.nl*

This paper explores the economic implications of the possible accession of Croatia to the European Union. Consumption per capita in Croatia is estimated to rise by about 2.5% as a result of accession to the internal market. If Croatia succeeds in reforming its domestic institutions in response to the EU-membership, income levels in Croatia could increase even more, by an additional 8%. Overall, the macroeconomic implications for the existing EU member states are negligible.

### *India and the Dutch economy: Stylised facts and prospects*

Wim Suyker, Henri de Groot and Piet Buitelaar, November 2007
*wim.suyker@cpb.nl*

See the article on page 3 of this Newsletter

## CPB Discussion Papers

### *89. Globalisation and the Dutch economy; a case study to the influence of the emergence of China and Eastern Europe on Dutch international trade*

Henri de Groot and Jessie Bakens, October 2007
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This paper investigates the impact, for a small open economy such as the Netherlands, of the emergence of China and Eastern Europe as increasingly important players on the world market. The authors conclude that the overlap in revealed comparative advantages between China and the Netherlands is limited and that the overlap in comparative advantage between China and Eastern Europe is relatively large, implying that competition from Eastern Europe is likely to be stronger than from China.

### *90. Measuring annual price elasticities in Dutch health insurance: A new method*

Rudy Douven, Harm Lieverdink, Marco Ligthart, Ivan Vermeulen, November 2007
*rudy.douven@cpb.nl*

This paper proposes a new method for estimating annual price elasticities from market share data of health insurers. This method explains the annual variation in the Dutch market share data better than the traditional methods. We find rather low negative annual price elasticities - ranging between 1 and 0 - in the Dutch social health insurance for the period 1996-2005. In that period, stickiness of insurer choices was high; less than 5% of the population switched annually from health insurer. This result, however, was in sharp contrast with an exceptional high price elasticity of 7 for the year 2006, where after a major health care reform about 18% of the population switched mostly to lower priced health insurers.

### *91. The costs and benefits of providing open space in cities*

Jan Rouwendal (VU) and Willemijn van der Straaten (CPB/VU), December 2007
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This paper analyses the provision of open space – parks and public gardens – from a welfare economic perspective. In the Netherlands, tight spatial planning restrictions put pressure on the use of urban space for private (residential) and public (parks and public garden) purposes. Land prices are high and choices with respect to alternative types of land use are of considerable importance. Moreover, amenities like parks and public gardens are potentially important for the attractiveness of the city as a place of residence for higher income households. To investigate these issues in some detail, we estimate demand functions for open and private space.

## Colofon

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# China and India are coming: hurrah! or watch out?

*Reactions in advanced economies to the emergence of China and India vary from euphoria over the great new opportunities on offer and the advantages such a development provides, to worries about the possibly dramatic consequences on competitiveness, employment, income distribution and the global environment. CPB has recently published three studies on this topic. This article uses insights from those studies to provide some answers to frequently asked questions.*

### How well are the Chinese and Indian economies performing?

Very well. In the past quarter of a century, both countries have experienced strong economic growth. As a result, income per capita is now nine times the level of 25 years ago in China, while in India it is three times as high. Poverty has dropped substantially.
Despite strong growth, however, average income per capita remains substantially lower in China and India than in advanced economies. In China, it is a quarter of the average Dutch income per capita. It is even lower in India: just above 10% of the average Dutch income.

### Why are these countries performing so well?

From the 1980s on, central planning has gradually been abolished. Firms were increasingly permitted to take their own decisions on investment, hiring and firing, production and prices. Both economies have, moreover, become distinctly more open. Restrictions on foreign trade have gradually been reduced. The same holds for foreign direct investment. This switch to a market-oriented economy has raised labour productivity. Despite these reforms, however, the role of the government (especially in China) remains much bigger than in the Netherlands.

### Are there drawbacks?

Absolutely. Accompanying the very rapid economic development are excesses with regard to working conditions and the environment. Compared with the Dutch welfare state, both countries are rough economies without substantial safety nets. Moreover, although per capita emissions in these countries are much lower than they are in the Netherlands and in other advanced economies, the emergence of China of India exacerbates the global warming problem.

### Does this mean greater competition for Dutch firms?

India and China generally export different products than the Netherlands. This is because the Dutch labour force is more highly skilled. In general, the export products of the two Asian countries complement, rather than compete with Dutch products.

### How do the developments in these two countries affect the Dutch economy?

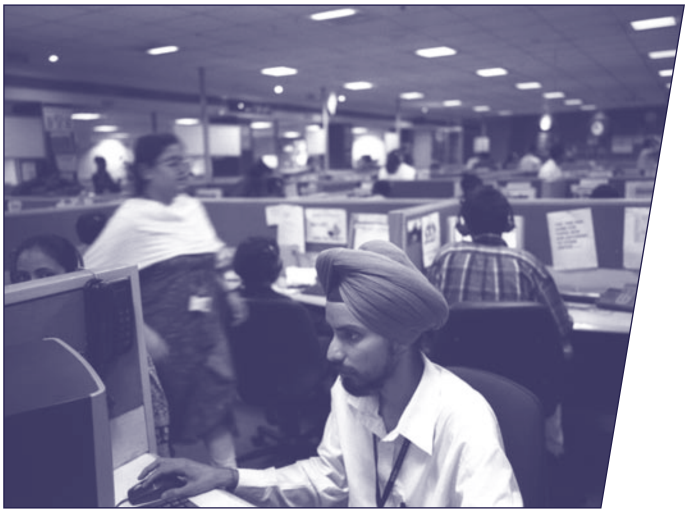
China and India have become important suppliers. Currently, almost 9% of goods imports into the Netherlands come from the two countries; in 1990 this was less than 1%. A substantial part of those imports are re-exported to the rest of Europe. The importance of the two countries as export markets has increased more modestly. In 2006, the share of China and India in total Dutch goods exports was 1.4% (it was only 0.4% in 1990). At present, exports to the two countries and re-exports of Chinese and Indian products account for between thirty- and forty thousand jobs in the Netherlands.

### Are China and India equally important for the Dutch economy?

Clearly not. For every container arriving from India in a Dutch seaport, 25 containers arrive from China.

### What will the future hold?

If current policy continues, both countries may have an economic growth of 8% per annum up to 2020. Under the most favourable circumstances, Dutch exports to India may expand fifteen-fold up to 2040, while exports to China may expand eleven-fold.



### What does this mean for Dutch economic policy?

The significance of India and other emerging economies for the Dutch economy is set to rise in years to come. As a result, Dutch consumers will benefit from the supply of a wide range of cheap products. Past experience has taught us that such positive developments entail structural adjustments. The adjustment process will not require specific, new policy measures, however. The existing social security framework, coupled with active labour market programmes that enable workers to quickly change jobs, should suffice. In addition, ongoing structural change in the global economy requires strengthening the ability of Dutch firms to innovate. Concerning environmental policy, continuing strong growth in the two major Asian countries will probably increase the global emission of greenhouse gases to such an extent that the Netherlands and other advanced economies will have to take tougher action to reduce their own emissions. □

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## Main Economic Indicators for the Netherlands, 2005-2008

| | 2005 a) | 2006 a) | 2007 | 2008 |
|---|---|---|---|---|
| | annual growth rate | | | |
| **International items** | | | | |
| Relevant world trade volume | 5.4 | 7.5 | 6¼ | 6 |
| Import price goods | 3.3 | 3.9 | 1 | ½ |
| Crude oil price (Brent, level in dollars per barrel) | 54.4 | 65.2 | 71 | 83 |
| Exchange rate (dollar per euro) | 1.24 | 1.26 | 1.37 | 1.44 |
| Unit labour costs competitors in manufacturing | – 0.3 | – 1.7 | – 3¼ | – 1¾ |
| **Demand and output (volume)** | | | | |
| Gross domestic product (GDP, economic growth) | 1.5 | 3.0 | 3 | 2¼ |
| Private consumption | 0.7 | – 0.8 (2.7) | 2 | 2 |
| Gross fixed investment. private non-residential | 1.4 | 10.0 | 3½ | 5½ |
| Private residential investment | 5.7 | 4.5 | 3½ | 2½ |
| Exports of goods (non-energy) | 6.7 | 8.4 | 7½ | 7¼ |
| of which domestically produced | 1.5 | 4.1 | 4¼ | 2½ |
| re-exports | 12.4 | 12.8 | 10¾ | 11½ |
| Imports of goods | 6.1 | 9.2 | 7½ | 7¼ |
| Production market sector b) | 2.3 | 4.1 | 4 | 2 |
| **Prices and wages** | | | | |
| Consumer price index (CPI) | 1.7 | 1.1 | 1½ | 2¼ |
| Price domestic expenditure | 2.1 | 2.1 | 2 | 2¼ |
| Export price goods (excluding energy) | 0.4 | 0.8 | ¼ | – ½ |
| Contractual wages market sector | 0.7 | 2.0 | 1¾ | 3¼ |
| Compensation per employee market sector | 1.4 (1.8) | 2.4 (2.7) | 2¼ | 4¼ |
| Unit labour costs in manufacturing | – 1.4 | – 0.3 | – ½ | 1¾ |
| **Labour market** | | | | |
| Unemployment rate (level in % of labour force) | 6.5 | 5.5 | 4½ | 4 |
| Unemployment (x 1000) | 483 | 413 | 345 | 310 |
| Employment (labour years) | – 0.3 (– 0.5) | 1.8 (1.5) | 2½ | 1¼ |
| Active labour force (persons) | 0.0 (– 0.3) | 2.2 (2.0) | 2¾ | 1½ |
| Labour force (persons) | 0.0 (– 0.2) | 1.2 (0.9) | 1¾ | ¾ |
| **Public sector** | | | | |
| General government financial balance (level in % of GDP) | – 0.3 | 0.6 | 0.0 | 0.5 |
| Gross debt general government (level in % of GDP) | 52.3 | 48.1 | 46.4 | 44.4 |
| Taxes and social security contributions (level in % of GDP) | 37.9 | 39.5 (38.0) | 39.4 | 40.0 |
| **Miscellaneous items** | | | | |
| Purchasing power | – 2.3 | 1.3 | 1 | 0 |
| Individual savings rate (in % of disposable income) | – 3.1 | – 2.3 | – 2 | – 2¾ |
| Labour productivity market sector b) | 2.7 (3.0) | 2.0 (2.3) | 1½ | 1 |
| Price gross value added market sector b) | 0.6 | – 0.5 | ½ | 1¾ |
| Real labour costs market sector b) | 0.8 (1.1) | 3.0 (3.2) | 1¾ | 2¾ |
| Labour share in enterprise income (level in %) | 78.6 | 79.4 | 79½ | 80¼ |
| Export surplus (level in % of GDP) | 8.0 | 7.4 | 6¾ | 7 |
| Long-term interest rate (level in %) | 3.4 | 3.8 | 4¼ | 4½ |

*a) Figures between brackets have been adjusted for changes in funding schemes caused by institutional reforms in sickness, disability insurance and health care. For more information, see http://www.cpb.nl/eng/pub/cepmev/explanation.pdf.*

*b) Excluding mining and quarrying and real estate activities.*