

In this issue:

- Ageing: take the bull by the horns!
- Recent publications
- Medical technology and welfare
- Main economic indicators

# CPB Newsletter

2006 September

3

CPB Netherlands Bureau for Economic Policy Analysis

## Take the bull by the horns!



Peter Kooiman

*Already, we live longer and get fewer children. Population increase will come to a stop. Historically, this is an unknown phenomenon. The number of retirees per worker will double, and this will be permanent. The transition, over the next 40 years or so, is likely to give rise to substantial tensions on the labour market. Population ageing is a relatively slow process, though, and there is still substantial slack in the potential labour force.*

Population ageing also entails increasing tension on the public budget. Current policies lead to a yearly recurring primary deficit of 2 – 3% of GNP from 2030 onwards. Including these future deficits the public balance features a deficit of 200% of GNP in present value. Its perpetual annuity amounts to 2.6% of GNP. The way in which we will address this sustainability problem is one of the main themes in the run-up to the forthcoming general elections of November 22. The Dutch economy is recovering strongly from the long and deep recession of the first half of this decennium. This provides opportunities to redress the budget. But will it happen? There are no easy solutions available.

Every year that we postpone adjusting public finances enlarges the problem for the subsequent years. Generally speaking, the best way to handle an inevitable loss is to spread it evenly over as

many years as possible. We should therefore shoulder our share of the ageing burden as soon as possible. Sharing of the burden involves different generations. Fundamentally, we are deciding to what extent we, our generation and that of our parents and our (grand)children will be burdened.

Apart from the question which share of the ageing burden we can and want to carry ourselves, there is another reason not to postpone action: the most effective policies to curb ageing costs require a prolonged announcement period. Such policies target in particular the costs involved in old-age provisions, such as the public base pension and public health care for people over 65. Reforming such provisions cannot be done in a fortnight. A major reduction of the generosity of public provisions for the elderly should be announced in a timely fashion so that citizens can adapt during their working life, e.g by increasing their private savings.

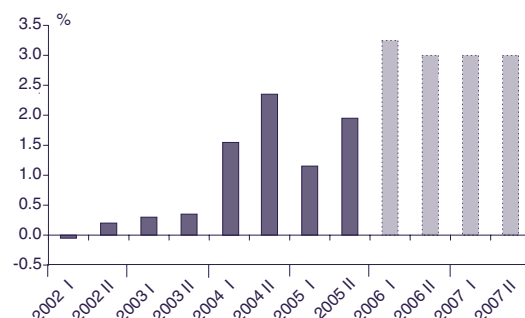
Since the eighties, CPB has prepared, prior to general elections, a comparative economic analysis of the election platforms. Until now, the main focus in this analysis was on the mid-term economic consequences of the policies proposed. This year, the analysis will include a systematic assessment of the extent to which these policies may succeed in restoring the long-term sustainability of the public budget. This enables voters to weigh up their own financial strength to that of younger generations. □

Peter Kooiman  
Head of the sector Labour market and welfare state

## CPB's short term forecasts September 2006

- Dutch GDP is expected to accelerate to 3¼% in 2006 and will slightly fall back to 3% next year.
- Domestic expenditures (private consumption, investment and government expenditures) and exports will equally contribute to economic growth in 2006 and 2007.
- Employment growth is expected to accelerate this year and next year. In both years, the unemployment rate will fall sharply, to 4½% on average in 2007.
- Wage growth is slightly increasing, but still moderate in 2006 and 2007, as is inflation.
- Government EMU-balance will nearly be in equilibrium in both forecasting years.

Economic growth in the Netherlands, 2002-2007<sup>a)</sup>



See the back page for the main economic indicators for the Dutch economy, or [www.cpb.nl](http://www.cpb.nl) for more information.

<sup>a)</sup> GDP volume growth rate compared to corresponding period in the previous year.

## Recent Publications

JUNE 2006 – SEPTEMBER 2006

*The following list provides an overview of recent CPB publications that have appeared in English between June and September 2006. All publications can be downloaded at [www.cpb.nl](http://www.cpb.nl). A press release on the publication is often also available from the website.*

### Forecasts

#### **Macro Economic Outlook 2007 (MEV, only in Dutch)**

[johan.verbruggen@cpb.nl](mailto:johan.verbruggen@cpb.nl)

MEV 2007 describes the situation for the Dutch economy and the international economy, and presents forecasts for the economic developments in 2006 and 2007. The special issues in this MEV are 'The importance of China for the Dutch economy' and 'The effectiveness of the police'. The accompanying press release provides an overview of the forecasts in English.

### CPB Documents

#### **125. Who benefits from tax competition in the European Union?**

Leon Bettendorf, Joeri Gorter and Albert van der Horst, August 2006  
[albert.van.der.horst@cpb.nl](mailto:albert.van.der.horst@cpb.nl)

Statutory tax rates have declined in the European Union in recent decades. An applied general equilibrium model on corporate taxation sheds light on the economic and welfare implications of tax rate reforms. Domestic distortions prove highly relevant as even unilateral reductions of the corporate income tax rate might reduce welfare if the labour tax rate has to be increased. Profit shifting induces countries to underbid each others's

tax rates, but this effect is sizable only if two countries are closely linked. The study shows that harmful external effects of CIT rate reductions are limited, which reduces the need for European coordination of CIT rates.

### CPB Discussion Papers

#### **66. The price of free advice**

Machiel van Dijk, Michiel Bijlsma and Marc Pomp, July 2006  
[machiel.van.dijk@cpb.nl](mailto:machiel.van.dijk@cpb.nl)

Which factors determine how well consumers make their actual choices with regard to financial products? This paper empirically evaluates two different choices consumers make when buying deferred annuities. One choice concerns the type of insurance policy, the other the choice of insurance provider. For both choices, the researchers analyse which factors explain the quality of the choice made. The results raise doubts about the functioning of both markets.

#### **67. Tobacco taxation in the European Union**

Sijbren Cnossen, July 2006  
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Later this year, the European Commission has to submit a report to the Council of Ministers and the European Parlia-

ment with its views on tobacco tax policy in the EU. This paper reviews and evaluates EU tobacco tax policies. It supports the move towards specific taxation, but notes that there are conceptual and empirical limits to excessively high tobacco taxes. Smokers appear to pay their way and cigarette smuggling is a growing menace to health and revenue objectives.

#### **68. Higher education; time for coordination on a European level?**

Laura Thissen and Sjef Ederveen, July 2006  
[arjan.lejour@cpb.nl](mailto:arjan.lejour@cpb.nl)

Education has always been regarded as a national matter. According to the subsidiarity principle, power may be shifted to a higher level of coordination only when solid arguments demonstrate that this will improve welfare. This paper aims at answering the question whether these arguments exist. No support was found for economies of scale, i.e. larger countries do not necessarily provide education of higher quality; nor do larger schools. Empirical evidence for human capital externalities through student mobility is scarce. Concluding, little support was found for European coordination of higher education.

#### **69. Hidden Unemployment in Disability Insurance in the Netherlands: An Empirical Analysis Based on Employer Data**

**70. Disability Insurance and Unemployment Insurance As Substitute Pathways: An Empirical Analysis Based**

#### **on Employer Data**

Pierre Koning and Daniel van Vuuren, August 2006  
[pierre.koning@cpb.nl](mailto:pierre.koning@cpb.nl)

In these papers, the authors estimate the degree of substitution between enrolment into Disability Insurance (DI) and Unemployment Insurance (UI) in the Netherlands. For this purpose, two longitudinal administrative data sets of Dutch employers for the period 1993-2003 have been used. They find that the (average) fraction of hidden unemployment in DI enrolment amounts to about 11%-26%. This corresponds to about 36% of the 'true' unemployment insurance (UI) enrolment rate of employers. Over the years, there is a strong decrease in this fraction, from 5.4% in 1995, to 0.7% in 2003. This decrease is likely to be related to the many policy measures taken during the 1990s, which were aimed at reducing DI enrolment.

## Colofon

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## Medical technology and welfare

*Ten years ago, a survey among American health economists found that 81% agreed with the statement that new medical technology is the main driver of rising health expenditure. Most health economists believe that this is still the case. Is all this new technology necessary? Do the benefits in terms of better health exceed the costs?*

These questions motivated the project *New medical technology, health expenditure and welfare*, carried out jointly with researchers at Erasmus University Rotterdam. Efficiency is an important concept in our analysis. It is therefore important to be clear about what this means in the case of medical technology. In the project, efficiency is defined as the cost per QALY: *Quality Adjusted Life Year*. In health economics, QALYs are the standard measure of health gains. One additional year in perfect health counts as one QALY, while one additional year with severe health problems could count as e.g. 0.7 QALY. A new medical technology is said to be more efficient the lower the costs per QALY gained.

Research on the cost-effectiveness of new medical technology allows ranking of technologies on the basis of costs per QALY (see table). But what is the use of such a ranking? Some health economists argue that it can be used for the optimal allocation of the health budget. The most efficient technology should be reimbursed first. If there is any budget left, the technology that ranks second in efficiency is reimbursed – and so on, until the budget is exhausted.

### Costs of medical technology per QALY (in euro's)

Cholesterol-reducing drugs for patients with cardiovascular disease	1000
Cataract operation	3600
Viagra to restore erectile function	5100
Calcium and vitamin D3 for elderly women with osteoporosis	6000
Antiviral therapy for HIV	11000
Drug for treating nail fungus	16000
Liver transplantation in case of severe liver dysfunctioning	19000
Lung transplantation in case of severe lung dysfunctioning	40000
Heart transplantation	40000
Liver transplantation as a consequence of alcohol abuse	147250

Source: Council for Public Health and Health Care (2006)

Only a minority among health economists favours such an approach, however. The received wisdom is that efficiency should be one amongst several criteria for deciding on reimbursement of new technologies. Fairness, severity of the disease and financial burden are legitimate criteria as well. This may justify the policy of

reimbursing relatively inefficient lung transplantations while not reimbursing the very efficient drug Viagra.

Moreover, the health budget is not fixed. If it turns out that the budget is insufficient to cover a new technology that society deems necessary, then the budget can be increased. However, this still raises the question: what is necessary? Where do we draw the line between e.g. efficient and inefficient? On this issue, there is no agreement. In past reimbursement decisions on vaccination programs in the Netherlands, a cut-off of 18 000 euro per QALY has been used. And the decision to reimburse Plavix only in special cases was based on the fact that the costs of Plavix amounted to almost 16 000 euro per QALY (Plavix is a drug that prevents heart and brain infarctions in patients at risk). However, the Dutch Council for Public Health and Health Care recently proposed a much higher maximum of 80 000 euro per QALY for patients with a heavy burden of disease. In support of this change, the Council points to research on wage differentials between safe and risky jobs and to surveys in which respondents were asked to put a monetary value on differences in health states. With many caveats, these studies allow one to attach an average monetary value to a QALY. Although the range of values in the literature is wide, many health economists conclude that the cut-off points that are being used in practice are (much) too low.

Apart from uncertainty about the level of the cut-off point, the cut-off point may also differ between different groups of patients and types of disease. For example, research indicates a far greater societal willingness to pay for an additional QALY of a young person than for an additional QALY of an elderly person. Adding further to the confusion, the cut-off point will probably change in the future although the direction of change is unclear. On the one hand, as we grow richer the willingness to pay for an additional QALY will rise, requiring a higher cut-off point. On the other hand, as more and more technology comes available, an unchanged cut-off point will lead to higher health expenditure. If the increase in expenditure is larger than we as a society deem acceptable, then the cut-off point needs to be adjusted downward.

All in all, research on the cost-effectiveness of new medical technologies does not lead to a clear-cut policy advice of the type 'this new technology should be adopted and that one not'. It is not clear where the line should be drawn between efficient and inefficient – and policymakers may have good reasons for also looking at other criteria besides efficiency. This does not make cost-effectiveness research less useful. Rational decision making on new medical technology is possible only if both the social costs and the social benefits of the available choices are known. □

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## Main Economic Indicators for the Netherlands, 2004-2007

	2004	2005 <sup>a)</sup>	2006 <sup>a)</sup>	2007
	annual growth rates			
<b>International items</b>				
Relevant world trade volume	7.6	5.5	7¾	6¾
Import price goods	0.6	3.3	4¾	1
Export price competitors	0.3	1.6	1¾	1
Crude oil price (Brent, level in dollars per barrel)	38.2	54.4	68	70
Exchange rate (dollar per euro)	1.24	1.24	1.24	1.25
Unit labour costs competitors in manufacturing	-4.5	0.0	-1½	-¾
<b>Demand and output (volume)</b>				
Gross domestic product (GDP, economic growth)	2.0	1.5	3¾	3
Private consumption	0.6	0.7	-1¼ (2)	2
Gross fixed investment, private non-residential	-2.2	3.1	5¾	4¾
Private residential investment	6.5	5.3	5½	4
Exports of goods (non-energy)	9.8	6.8	7¾	7½
of which domestically produced	6.5	1.9	4¼	3½
re-exports	13.6	12.4	11¾	11½
Imports of goods	8.8	6.0	7¾	7
Production market sector <sup>b)</sup>	2.2	2.3	3½	3¾
<b>Prices and wages</b>				
Consumer price index (CPI)	1.2	1.7	1¼	1½
Price domestic expenditure	1.1	1.7	1¾	1¾
Export price goods (excluding energy)	-0.5	0.6	1	½
Price competitiveness	-0.2	-1.3	-¼	0
Contractual wages market sector	1.5	0.8	1¾	2
Compensation per employee market sector	3.9	1.3 (1.6)	1½ (1¾)	2½
Unit labour costs in manufacturing	-1.5	-0.8	-2¾	-1½
<b>Labour market</b>				
Unemployment rate (level in % of labour force)	6.5	6.5	5½	4½
Unemployment (x 1000)	479	483	400	345
Employment (labour years)	-1.4	-0.3 (-0.6)	1¾ (1¼)	1½
Active labour force (persons)	-1.2	0.0 (-0.3)	2 (1½)	1¾
Labour force (persons)	0.0	0.0 (-0.2)	¾ (½)	1
<b>Public sector</b>				
General government financial balance (level in % of GDP)	-1.8	-0.3	-0.1	0.0
Gross debt general government (level in % of GDP)	52.6	52.7	50.2	47.9
Taxes and social security contributions (level in % of GDP)	37.7	38.2	39.6 (38.1)	39.1
<b>Miscellaneous items</b>				
Purchasing power	0.1	-1.7	1¾	1¼
Individual savings rate (in % of disposable income)	-1.6	-2.8	-3	-2½
Labour productivity market sector <sup>b)</sup>	4.5	2.9 (3.1)	1¾ (2¼)	2¼
Price gross value added market sector <sup>b)</sup>	-0.3	-0.1	-1¾	1
Real labour costs market sector <sup>b)</sup>	4.2	1.4 (1.7)	3¼ (3½)	1½
Labour share in enterprise income <sup>b)</sup> (level in %)	80.1	79.0	80¼	79¼
Export surplus (level in % of GDP)	7.2	7.7	7½	7½
Long-term interest rate (level in %)	4.1	3.4	3¾	4¼

<sup>a)</sup> 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>.

<sup>b)</sup> Excluding mining and quarrying and real estate activities.