ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

# Regulatory Reform in the Netherlands

*OECD Reviews of Regulatory Reform*

# REGULATORY REFORM IN THE NETHERLANDS

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

## ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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# FOREWORD

The OECD Review of Regulatory Reform in the Netherlands is among the first of a series of country reports carried out under the OECD's Regulatory Reform Programme, launched in 1998 in response to a mandate by OECD Ministers.

The Regulatory Reform Programme is aimed at helping governments improve regulatory quality – that is, reforming regulations which raise unnecessary obstacles to competition, innovation and growth, while ensuring that regulations efficiently serve important social objectives.

The Programme is part of a broader effort at the OECD to support sustained economic development, job creation and good governance. It fits with other initiatives such as our annual country economic surveys; the Jobs Strategy; the OECD Principles of Corporate Governance; and the fight against corruption, hard-core cartels and harmful tax competition.

Drawing on the analysis and recommendations of good regulatory practices contained in the *1997 OECD Report to Ministers on Regulatory Reform*, the Regulatory Reform Programme is a multi-disciplinary process of in-depth country reviews, based on self-assessment and on peer evaluation by several OECD committees and members of the International Energy Agency (IEA).

The country Reviews are not comprehensive, but, rather, targeted at key reform areas. Each Review has the same structure, including three thematic chapters on the quality of regulatory institutions and government processes; competition policy and enforcement; and the enhancement of market openness through regulatory reform. Each Review also contains chapters on sectors such as electricity and telecommunications, and an assessment of the macroeconomic context for reform in the country under review.

The country Reviews benefited from a process of extensive consultations with a wide range of government officials (including elected officials) from the country reviewed, business and trade union representatives, consumer groups, and academic experts from many backgrounds.

These Reviews demonstrate clearly that in many areas, a well-structured and implemented programme of regulatory reform has brought lower prices and more choice for consumers, helped stimulate innovation, investment, and new industries, and thereby aided in boosting economic growth and overall job creation. Comprehensive regulatory reforms have produced results more quickly than piece-meal approaches; and such reforms over the longer-term helped countries to adjust more quickly and easily to changing circumstances and external shocks. At the same time, a balanced reform programme must take into account important social concerns. Adjustment costs in some sectors have been painful, although experience shows that these costs can be reduced if reform is accompanied by supportive policies, including active labour market policies, to cushion adjustment.

While reducing and reforming regulations is a key element of a broad programme of regulatory reform, country experience also shows that in a more competitive and efficient market, new regulations and institutions are sometimes necessary to assure that private anticompetitive behaviour does not delay or block the benefits of reform and that health, environmental and consumer protection is assured. In countries pursuing reform, which is often difficult and opposed by vested interests, sustained and consistent political leadership is an essential element of successful reform efforts, and

transparent and informed public dialogue on the benefits and costs of reform is necessary for building and maintaining broad public support for reform.

The policy options presented in the Reviews may pose challenges for each country concerned, but they do not ignore wide differences between national cultures, legal and institutional traditions and economic circumstances. The in-depth nature of the Reviews and the efforts made to consult with a wide range of stakeholders reflect the emphasis placed by the OECD on ensuring that the policy options presented are relevant and attainable within the specific context and policy priorities of each country reviewed.

The *OECD Reviews of Regulatory Reform* are published under the responsibility of the Secretary-General of the OECD, but their policy options and accompanying analysis reflect input and commentary provided during peer review by all 29 OECD Member countries and the European Commission and during consultations with other interested parties.

The Secretariat would like to express its gratitude for the support of the Government of the Netherlands for the OECD Regulatory Reform Programme and its consistent co-operation during the review process. It also would like to thank the many OECD committee and country delegates, representatives from the OECD's Trade Union Advisory Committee (TUAC) and Business and Industry Advisory Committee (BIAC), and other experts whose comments and suggestions were essential to this report.

# ACKNOWLEDGEMENTS

This series of Reviews of Regulatory Reform in OECD countries was prepared under the direction of Deputy Secretary-General **Joanna R. Shelton**. The Review of the Netherlands reflects contributions from many sources, including the Government of the Netherlands, Committees of the OECD and the IEA, representatives of Member governments, and members of the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC), as well as other groups. This report was peer reviewed in March 1999 in the OECD's *ad hoc* Multidisciplinary Group on Regulatory Reform.

In the OECD Secretariat, the following people contributed substantially to the review of the Netherlands: **Head of Programme and lead drafter**: Scott H. Jacobs; **Document preparation**: Jennifer Stein; **Economics Department**: Chapter 1 was principally prepared by Richard Kohl, and benefited from work by Giuseppe Nicoletti on regulatory indicators; **Public Management Service**: Rex Deighton-Smith; **Trade Directorate**: Evdokia Moïsé, Anthony Kleitz; **Directorate for Financial, Fiscal and Enterprise Affairs**: Patricia Heriard-Dubreuil, Patrick Hughes, Bernard J. Phillips, Sally Van Siclen, Michael Wise; **Directorate for Science, Technology, and Industry**: Wonki Min, Dimitri Ypsilanti; **General Secretariat**: Pierre Poret. In the **International Energy Agency**: Peter Fraser, Caroline Varley.

# TABLE OF CONTENTS

*Part I*



## Tables



## Figures



## Annex Figures

## Boxes



*Part II*

*Part I*

# OECD REVIEW OF REGULATORY REFORM IN THE NETHERLANDS

# EXECUTIVE SUMMARY

Regulatory reform in the Netherlands carries important lessons for other OECD countries about the modernisation of the European welfare state and its integration into the developing European single market. During much of the post-war period, the Dutch corporatist model, in which state sovereignty over public policy was shared with organised business and labour, was praised for its capacity for flexible adjustment, social stability, and pragmatic solutions, based on social consensus, to changing external conditions. The regulatory system, influenced by "insiders", often reflected producer interests in protected markets, but was also said to protect consumers and mediate concerns about social equity.

Yet the flexibility of the Dutch system degraded over time and, as rigidities accumulated and the external environment deteriorated, the welfare state ran into trouble. Low labour force participation and unsustainable welfare policies led to a severe crisis in the early 1980s, and forced re-examination of Dutch post-war economic policies. The corporatist approach was blamed for exacerbating policy rigidities and weakening competition, yet was praised for enabling social agreements in areas such as wage moderation that led to economic recovery. Policy reforms were further supported by the increased integration of the Dutch economy into Europe through the Single Market in the 1990s.

Regulatory reform, which began in the late 1980s and has accelerated in the past five years, is the most recent element in the reshaping of the Dutch model. Following reforms to labour markets and the social welfare system in the 1980s, Dutch governments in the 1990s have sought a "*new balance between protection and dynamism*" based on competition policy, regulatory reform, and market openness. Competition and regulatory quality are being strengthened through three strategies: adoption of a new competition law based on European-level mandates; increased exposure of the public sector itself to market forces; and a multi-faceted programme on the "Functioning of Markets, Deregulation and Legislative Quality" (MDW) to improve the cost-effectiveness of the extensive web of national and European regulations affecting economic activity.

Regulatory and competition policy reforms in the Netherlands have helped to sustain and expand earlier gains from labour and social security reforms. Though still in its early stages, regulatory reform has produced major benefits for the Netherlands by:

– Reducing the cost structure of exporting, distribution, and transit sectors to improve competitiveness in European and global markets. Increased efficiency has particularly high payoffs for small open economies such as that of the Netherlands.

– Addressing the lack of flexibility and innovation in the supply-side of the economy, which will be an increasing constraint to growth. Rigidities are especially costly in opening European markets where competition is intensifying, and will further intensify under the single currency.

– Boosting consumer benefits by reducing prices for services and products such as electricity, transport, and health care, and by increasing choice and service quality. The convenience of longer shop hours, for example, has been welcomed by consumers.

– Helping to increase employment rates by creating new job opportunities, and by doing so reducing fiscal demands on social security programmes, particularly important in an ageing population. Positive employment effects will be limited, however, without further reforms to the social

security system, further labour market reforms, active measures to reintegrate the large stock of disabled workers, and further upskilling of the workforce.

– Maintaining and increasing high levels of regulatory protections in areas such as health and safety, the environment, and consumer interests by introducing more flexible and efficient regulatory and non-regulatory instruments, such as market approaches. Reforms that enhance policy responsiveness allow the administration to react to rapidly changing environments and new policy problems.

But reforms are far from complete. Important challenges remain, including increasing utilisation of the potential labour force, reducing government debt, improving poor performance in some non-traded-goods sectors, and using market mechanisms in the pursuit of social objectives. At the same time, the economy faces new challenges from the completion, within the European single market, of deregulation of infrastructure sectors, from increasing globalisation, from the rapid pace of technological progress and the resulting structural change in OECD economies, and from population ageing. Regulatory reform has played and can continue to play an important role in the policy response to these challenges.

Chapter 1: *Regulatory reform addresses supply-wide weaknesses exposed by macroeconomic reforms of the 1980s, and, although in the early stages, has already boosted productivity in key sectors*. Since 1982, reforms to labour markets and the social welfare system have increased labour market flexibility, moderated real wage growth and improved long-term competitiveness. Recent analysis also suggests that reforms may have helped reduce inflation. Dutch economic performance has greatly improved, but continuing problems suggest the existence of durable supply-side rigidities and weaknesses. These weaknesses are an important drag on current performance, and reforms can boost future performance as competition intensifies in regional and global markets. Most sector-specific reforms are recent, and largely in transportation and services, but have already increased productivity in infrastructure industries. However, many sheltered sectors and public sector activities are as yet untouched. Expansion of market forces in public services, transport, and health care services promise substantial gains for consumers.

Chapter 2: *New regulatory approaches based on transparency, empirical analysis, and competition principles are helping regulators achieve public policies more efficiently in competitive markets*. The shift to market-oriented regulatory policies and instruments has required major reform of the Dutch public sector. Dutch political and administrative cultures have strong corporatist elements that help maintain consensus, but that have also produced a regulatory system that is complex, detailed, nontransparent, and closely tied to interest groups. The key challenges in the Netherlands with respect to regulatory quality are *1)* improving the transparency and responsiveness of the regulatory system as a whole, and *2)* upgrading the quality of social regulations to deliver public services such as environmental protection and health and safety with the best use of the country's resources. Working within these constraints, the MDW and other reform programmes began slowly but are now accelerating in terms of results. Quality standards based on good regulatory principles; decision tools such as regulatory impact analysis; and more transparent processes such as open public consultation have been adopted. These tools are being used to find more efficient ways to maintain levels of protection. But concerns about the complexity and rigidity of the national regulatory system continue to be voiced.

Chapter 3: *The dynamic and adaptive capacities of the Dutch economy are stimulated by competition policy reform that is removing many barriers to entry that had grown up under the welfare state*. Competition policy has been central to regulatory reform. The linchpin reform was adoption of a new competition law, taking effect in January 1998, that harmonised Dutch law with European law and introduced merger control. Previously, lax enforcement, widespread private agreements, and private and public regulations controlling entry and prices reduced the intensity of market competition in many sectors, particularly sheltered sectors. Competition barriers were largely explained by concerns about fairness, distribution, and small business. The Netherlands' principal reason for strengthening competition policy is to respond to the increasing interconnection of national economies by harmonising with European law, and to enhance the country's ability to adjust. Government commitment, the modern law, and the

well-designed new enforcement agency with strong leadership represent the principal strengths on which further reform can build.

Chapter 4: *The Netherlands' dependence on export-led growth has provided strong incentives to improve the transparency and efficiency of regulations in traded sectors. Market openness supports and is supported by the spread of competition and good regulatory practices throughout the economy.* Dutch prosperity has been largely dependent on foreign trade and investment, resting on a long tradition of market openness. Most regulatory processes have operated in a transparent and open manner which seeks to fulfil policy objectives while avoiding unnecessary trade restrictiveness and reducing technical barriers to trade. For example, the Netherlands has a good record of using internationally harmonised measures and recognising equivalence of conformity assessment performed abroad. As markets open in Europe, stronger incentives to reduce costs for exporting firms will support regulatory reform in service sectors, and reforms to further enhance the market orientation of regulation will maintain the Dutch lead in the liberalisation of global markets. However, the benefits of policies geared towards market openness have been reduced in the past by corporatist traditions that disadvantage new entrants. Reforms undertaken in other areas, in particular in competition policy, have had a positive effect on market openness.

Chapter 5: *Regulatory reforms required by the Single Market in the electricity sector provide the opportunity to establish new market-oriented institutions and policies. The Dutch response holds good prospects for future economic and environmental performance, but benefits may be reduced by incremental and incomplete changes in some areas.* A new electricity law will liberalise the Dutch electricity market in stages between 1999 and 2007. Liberalisation of the sector results from three drivers: broader government efforts at regulatory reform, a desire to address problems with the current electricity regulatory framework, and compliance with EU directives. A new network regulator will work in co-ordination with the new competition authority. New independent entities – the transmission and distribution network managers – are to be created to ensure non-discriminatory access to the networks. A green certificates program is a laudable attempt to establish a transparent market-based mechanism for the development of renewable resources. These reforms offer good prospects for generation competition and efficiency. But in other areas, the reforms are incremental and incomplete.

Chapter 6: *In telecommunications, the Dutch moved beyond European requirements for market liberalisation, which has paid off through entry of a large number of new firms. The main regulatory challenges today are to manage the presence of a dominant incumbent and to design regulatory regimes consistent with the convergence of telecommunications and broadcasting.* The Netherlands has regulatory safeguards that should ensure fair competition between the incumbent and new entrants. A new independent regulatory body, called OPTA, was established in August 1997. In October 1998, a new Telecommunications Act took effect, aiming at full competition in all telecommunications activities and complete implementation of EU principles. The Act includes new regulatory provisions and safeguards to prevent the incumbent from leveraging its dominant market position. The Act foresees the government (including OPTA) remaining as a key player in the market until it can be shown that the market or specific segments of the market are sufficiently competitive to allow the government to forebear from regulation. The Netherlands has an advantage in infrastructure competition due to its ubiquitous CATV network which potentially could be used as an alternative to the incumbent's bottleneck facility (the local loop).

Chapter 7: *Conclusions and Policy Options*. The major lessons that can be learned from regulatory reform in the Netherlands are:

– *The combination of competition, market openness, and regulatory quality in the current reform programme shows potential as an effective policy mix for improving economic dynamism, while achieving public policy objectives.*

– *A comprehensive approach produces more benefits. Sectoral regulatory reform in the Netherlands was more effective when coupled with flexibility in other sectors.*

– *Dutch consensus-building traditions have resulted in incremental and slow but, in many cases, steady progress in regulatory reform. Yet new methods of marrying consensus with greater policy responsiveness to changing conditions are being explored. For example, reforms are moving the Dutch administration away from regulatory processes dominated by "insiders" toward more transparent and empirical processes, while attempting to maintain the benefits of*

*consensual decision-making. Evolving Dutch experiences may be valuable to other countries seeking to gain stakeholder support for reform, while avoiding "capture" by special interests and damaging policy rigidities.*

– *Regulatory reform in the Netherlands is inextricably tied to the opportunities and constraints in the European Union. The Single Market Programme has been a valuable stimulus for beneficial regulatory and competition reforms in many areas, though the Dutch government also notes that some detailed European regulations may not meet Dutch standards for regulatory quality.*

Based on international experience with good regulatory practices, several reforms (further detailed in Chapter 7) are likely to be beneficial to improving regulation in the Netherlands:

– *The scope of regulatory reform should be expanded, and its pace accelerated.* Reform proposals have been delayed for years, eroding the benefits of reform, limiting the areas under reform, and raising serious concerns about future policy responsiveness. This may require new working methods to preserve the benefits of consultation and consensus-building.

– *Regulations should be reviewed systematically to ensure that they continue to meet their intended objectives efficiently and effectively.* Regulatory reviews under the MDW project should be continued, expanded, made systematic, and more transparent. Areas subject to a fast technological change or where regulatory failure is most costly should have highest priority. These include insurance, housing siting and construction, education, environment, broadcasting, network industries, public services such as health care, transport and water, and barriers to entrepreneurship.

– *Cost-effectiveness of government action should be increased by strengthening the role and rigour of regulatory impact analysis (RIA).* RIA, when well prepared, helps increase the net social benefit of regulations, and can be a powerful aide to delivering public services more cost-effectively.

– *Institutions responsible for competition, regulation and reform should be strengthened, and policy linkages better co-ordinated.* Dutch reforms have created several new regulatory agencies and offices with statutory responsibility for regulating, reforming, or promoting competition. In some cases, responsibilities were not effectively divided, and problems with policy co-ordination and linkages have not been resolved, which could weaken regulatory policies in the future.

– *In the electricity and telecommunications sectors, further restructuring, regulatory reform, and market-opening would boost consumer benefits.* The report provides more detail on beneficial steps.

– *Regulatory powers shared with non-governmental bodies should be tightly controlled to maintain a level playing field and open markets.* A form of regulation widely used in the Netherlands is "co-regulation", or sharing of regulatory functions between government and industry, common to corporatist approaches. The incentives that exist for rent-seeking require that the government more carefully supervise the use of delegated and self-regulatory powers than it has in the past.

*Chapter 1*

# REGULATORY REFORM IN THE NETHERLANDS

## INTRODUCTION

***The Dutch experience has lessons about the modernisation of the European welfare state and its integration into the European single market.***

Regulatory reform in the Netherlands carries important lessons for other OECD countries about the modernisation of the European welfare state and its integration into the developing European Single Market. During much of the post-war period, the Dutch corporatist model, in which state sovereignty over public policy was shared with organised business and labour, was praised for its capacity for flexible adjustment, social stability, and pragmatic solutions, based on social consensus, to changing external conditions. Although the regulatory system, influenced by "insiders", often reflected producer interests in protected markets, it was also seen to protect consumers and mediate concerns about social equity.

***As rigidities accumulated, the welfare state ran into trouble.***

Yet the flexibility of the Dutch system degraded over time and, as rigidities accumulated and the external environment deteriorated, the welfare state ran into trouble. Low labour force participation and unsustainable welfare policies led to a severe crisis in the early 1980s, and forced re-examination of Dutch post-war economic policies and the corporatist system. Policy reforms were further supported by the increased integration of the Dutch economy into Europe through the single market in the 1990s. Social changes within Dutch society, such as the growing importance of consumer and environmental concerns, further supported reconsideration of producer-oriented policies.

***Turnaround began with agreement among the social partners that made possible a continuing process of reforms.***

The corporatist approach was blamed for exacerbating policy rigidities, slowing adjustment, and weakening competition, yet was praised for enabling social agreements in areas such as wage moderation that led to economic recovery. The turnaround began with agreement among the social partners that made possible a continuing process of reforms. The initial reforms, particularly those to labour markets and the social welfare system, increased labour market flexibility, moderated real wage growth, restored public finances and improved long-term competitiveness. Today, the Netherlands ranks among the top OECD countries by many measures of economic performance, including employment growth.

***Dutch governments in the 1990s have sought a "new balance between protection and dynamism" based on competition policy, regulatory reform, and market openness.***

Regulatory reform, which began in the late 1980s and has accelerated in the past five years, is the most recent element in the reshaping of the Dutch model. It has only begun to contribute to Dutch economic performance. Following reforms to labour markets and the social welfare system in the 1980s, Dutch governments in the 1990s have sought a "*new balance between protection and dynamism*" based on competition policy, regulatory reform, and market openness. Competition and regulatory quality are being strengthened through three strategies: adoption of a new competition law based on European-level mandates; increased exposure of the public sector itself to market forces; and a multi-faceted programme on the "Functioning of Markets, Deregulation and Legislative Quality" (MDW) to improve the cost-effectiveness of the extensive web of national and European regulations affecting economic activity. Dutch regulation today is, in fact, substantially driven by European-level policies and regulations, which presents both opportunities and constraints for regulatory reform.

***Change has been moderated by the need to visibly protect social concerns, and slowed by opposition from entrenched economic interests.***

These principles have been pragmatically applied within a strong social consensus for security and equity. The long-term rebalancing of corporatist traditions with more market-based decision-making, and the shift from pro-producer to pro-consumer regulation, has been moderated by a belief in the continuing economic and social value of the "Dutch consultative economy",[1] as well as by the need to visibly protect social concerns. Reforms have also been slowed by opposition from entrenched economic and social interests. Concern from labour and religious groups over the "24-hour economy", for example, delayed the deregulation of shop hours.

***Regulatory reform is needed to stay competitive, enhance growth and innovation, and respond to consumer needs.***

The process of regulatory reform has been driven by at least three key considerations. Firstly, the high degree of openness of the Dutch economy and its heavy reliance on exports and distribution requires high efficiency and low cost in all sectors of the economy, particularly in those that are linked to the distribution function. Secondly, regulatory reform is required to enhance the ability of the economy to adapt to external shocks, and to give greater room for growth and innovation in new sectors. In turn, this may promote employment growth and bring low labour force participation in the Netherlands more in line with other OECD countries. Thirdly, regulatory reform is needed to adapt to emerging consumer needs, such as longer opening hours and greater flexibility in customer service.

***Questions now confronting the Netherlands are how to sustain competitiveness, generate private sector employment, and reduce government debt, while maintaining social equity.***

Dutch regulatory reforms have started well, and are already producing gains for consumers, but are far from complete. Important challenges remain, including increasing utilisation of the potential labour force, reducing government debt, improving poor performance in certain non-traded-goods sectors, and a greater use of market mechanisms in the pursuit of social objectives. At the same time, the economy faces new challenges from the completion, within the European single market, of deregulation of infrastructure sectors, from increasing globalisation, from the rapid pace of technological progress and the resulting structural change in OECD economies, and from population ageing. Regulatory reform has played and can continue to play an important role in the policy response to these challenges.

***Gains from current regulatory reform efforts could be slowed or blocked, and the challenge is to sustain momentum.***

Moreover, the Dutch government faces difficulties that slow or block the gains from current regulatory reform efforts. On the one hand, the Dutch consensus model can facilitate reform by mediating conflict and gaining stakeholder support. Social cohesion is protected, because the reforms are seen as part of an overall strategy that is fair overall. The reforms are therefore broadly accepted and there is little risk of reversal of implemented reforms. On the other hand, in a decision-making system characterised by consensus-building and negotiation, decisions on reform proposals can be very slow, and sometimes incoherent, though recent efforts to streamline decision processes may help. Many unanswered questions about the direction and depth of reform will be faced in the short and medium terms; hence, much will depend on consistency and strength of political support, and continued agreement among the political coalitions and social partners, for market-based approaches to economic and social progress.

***Yet the country is on track toward creation of a more open, competitive, and market-based economy, backed up by strong social safety nets.***

While the process is slow, regulatory reforms are changing the supply side of the Dutch economy. The country is on track towards the creation of a more open, competitive, and market-based economy, backed up by strong social safety nets. Toughened by growing domestic competition, Dutch firms are increasingly well-positioned to benefit from European integration and to adapt to changing economic conditions. Experience with regulatory reform provides further evidence

### Box 1.1. What is regulation and regulatory reform?

There is no generally accepted definition of regulation applicable to the very different regulatory systems in OECD countries. In the OECD work, **regulation** refers to the diverse set of instruments by which governments set requirements on enterprises and citizens. Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to whom governments have delegated regulatory powers. Regulations fall into three categories:

- ***Economic regulations*** intervene directly in market decisions such as pricing, competition, market entry, or exit. Reform aims to increase economic efficiency by reducing barriers to competition and innovation, often through deregulation and use of efficiency-promoting regulation, and by improving regulatory frameworks for market functioning and prudential oversight.
- ***Social regulations*** protect public interests such as health, safety, the environment, and social cohesion. The economic effects of social regulations may be secondary concerns or even unexpected, but can be substantial. Reform aims to verify that regulation is needed, and to design regulatory and other instruments, such as market incentives and goal-based approaches, that are more flexible, simpler, and more effective at lower cost.
- ***Administrative regulations*** are paperwork and administrative formalities – so-called "red tape" – through which governments collect information and intervene in individual economic decisions. They can have substantial impacts on private sector performance. Reform aims at eliminating those no longer needed, streamlining and simplifying those that are needed, and improving the transparency of application.

**Regulatory reform** is used in the OECD work to refer to changes that improve regulatory quality, that is, enhance the performance, cost-effectiveness, or legal quality of regulations and related government formalities. Reform can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform. Deregulation is a subset of regulatory reform and refers to complete or partial elimination of regulation in a sector to improve economic performance.

*Source:* OECD (1997), *The OECD Report on Regulatory Reform*, Paris.

that – given time, determination, and motivation from the European single market – successful reform of the welfare state is possible.

## FROM DUTCH DISEASE TO THE DUTCH CURE: THE MACROECONOMIC CONTEXT FOR REGULATORY REFORM

### The policy tools by which economic and social goals were pursued contained inherent contradictions…

*The two pillars of Dutch development were international competitiveness and the social market economy.*

Dutch economic strategy in the post-war period was based on export-led growth and a social market economy. Emphasis on trade and distribution led to commitments to market openness and development of a solid infrastructure. Market openness[2] was anchored in membership in institutions such as the EU and the GATT, and by fixed exchange rates. The Netherlands maintained its historic role as an international shipping and distribution centre, complementing its world class seaport and inland road and water transport infrastructure with high-quality telecommunications, rail transport and postal services, all provided by the public sector, as in most European countries.

*Social goals – to ease the costs of adjustment and to maintain full employment – were addressed by state intervention, such as regulation of prices.*

Social goals – to ease the costs of adjustment and to maintain full employment – were increasingly addressed by a defensive industrial policy including large subsidies to support declining industries, SMEs and traditional economic activities; the establishment of a comprehensive and generous social welfare system; labour market regulations and institutions that favoured workers' rights; and centralised or sectorally organised wage bargaining by the social partners. The state, often in co-operation with business and union organisations, regulated the economy through mechanisms such as setting maximum and minimal prices or permissible price increases on various commodities. In many areas, the state delegated self-regulation or management authority partly or completely to the social partners.

*Fiscal and regulatory policies bore the full weight of reconciling economic and social policies.*

These arrangements contained inherent contradictions. External commitments limited the discretionary use of monetary, exchange rate, and trade policies. The only discretionary macropolicy tool was fiscal policy, although subject to the usual budget constraints. Public and private regulation that inhibited competition was a convenient micropolicy tool. Because the exchange rate could not be controlled, competitiveness could be maintained only by internal structural adjustment and flexibility. But flexibility was inhibited by regulatory, social and labour market institutions that blocked competition, weakened work incentives, decreased labour mobility and compressed wage differentials. Fiscal and regulatory policies were expected to bear the costs of maintaining the social welfare system without imposing tax and regulatory burdens that discouraged hiring and investment.

### … that produced "Dutch Disease" when strong external shocks hit the economy in the 1970s.

*The contradictions came into full view when higher real exchange rates interacted unpleasantly with economic rigidities.*

The contradictions came into full view in the 1970s when Dutch economic performance deteriorated as higher real exchange rates and a slowdown in world economic growth interacted with the rigidities caused by labour and social market policy and lack of competition in many sectors. The Dutch economy faced the oil price shocks that

hit other OECD economies, but earnings from natural gas production allowed the Netherlands to postpone adjustment.

*Real wages grew faster then productivity even as terms of trade declined.*

In non-energy sectors, real wages and compensation grew faster than productivity, though these sectors faced higher real exchange rates and a decline in domestic terms of trade. Minimum wages rose in the 1970s as wage gains in key sectors were extended by contract to much of the economy. Employers in non-traded sectors, particularly those sheltered from competition by monopolies or cartels, were able to substantially increase pay without affecting competitive positions since the entire industry paid the same wages. These wage settlements hurt the traded-goods sector by raising costs of intermediate inputs and by putting upward pressure on wages as trade unions sought to maintain income parity.

*The result was rapid deterioration in economic performance.*

The result was rapid deterioration in economic performance: lower manufacturing profitability, sluggish investment, slower growth in capital stock and productivity, and increasing unit labour costs. Competitiveness and export growth declined, business employment stagnated, and unemployment rose. Rising sectoral minimum wages and compression of wage differentials, both within and between industries, made it increasingly difficult for low-skilled workers to find employment. High youth unemployment and mismatches between labour demand and supply became persistent problems.[3]

**The government response – more spending – worsened the crisis, and led to the emergence of a deep recession.**

*By 1980, government expenditures accounted for nearly 56 per cent of national income, amongst the highest in the OECD.*

The government responded by cutting taxes on investment and by increasing spending. Spending on public investment, on direct support to industry, and on expanding the safety net rose substantially.[4] Government employment increased rapidly, as did the number of people on early retirement or disability pensions.[5] By 1980, government expenditures accounted for nearly 56 per cent of GDP, among the highest in the OECD. These expenditures were financed initially by a surge in revenues from natural gas earnings, and then higher taxes (social security contributions), and eventually by increases in public sector deficits.

*A vicious circle emerged. Weaker economic performance led to more government spending, putting even more pressure on the private sector.*

Indexing generous social benefits to private sector wages, rather than price levels, created upward pressures on wages, and higher taxes increased other compensation costs.[6] These pressures squeezed private sector profits, particularly in traded goods sectors. Interest rates rose because of the growing budget deficit, leading to "crowding-out" of investment. These factors created a vicious circle of weaker private sector performance, falling private employment, rising government employment and social transfer benefits, culminating in higher government expenditures, tax rates, and deficits, putting even more pressure on the private sector.

*The recession of 1981-83, among the worst in Dutch history, made deep policy reforms possible.*

The recession of 1981-83 convinced the nation that reform was inevitable.[7] Exports stagnated and business investment collapsed. Consumption fell sharply as labour market conditions worsened

and housing prices fell, reducing consumer wealth. Real wages and compensation fell for three years in a row.[8] Between 1979 and 1983, GDP growth was near zero and unemployment surged from 4 to 11 per cent. Total social expenditures surpassed 30 per cent of GDP, one of the highest levels in the OECD at the time. By 1982 the public sector deficit had reached 6.6 per cent of GDP.[9]

### Reforms focused on lowering fiscal deficits and moderating wages…

*Wage moderation was needed to protect jobs, bring down unemployment and restore competitiveness.*

The top priority of the government was to reduce the budget deficit and restore public finances, leaving little room for a counter-cyclical increase in government spending. And discretion to use monetary and exchange rate policy was limited.[10] Faced with a deepening crisis and few traditional policy tools, a narrow consensus emerged on the need for wage moderation to protect jobs, bring down unemployment and restore competitiveness. Regulatory reform was not included in the initial package of measures.

*Fundamental institutional reforms to the social market economy were launched in the 1980s, setting the stage for regulatory reform.*

Policy measures in 1982 and 1983 began a period of fundamental institutional reforms to the social market economy which continue today with the addition of regulatory reform.[11] The "Wassenaar agreement", encouraged by the government but negotiated by the social partners, helped restore confidence when employees' federations agreed to wage moderation in exchange for reduced working hours and job creation. The government for its part eased statutory restrictions on private sector wage bargaining, and froze (then reduced) social security benefits, minimum wages and public sector salaries. This process continued over several years. Social reforms were complemented by fiscal reforms, particularly to the tax system. The main corporate tax was cut from 48 to 35 per cent. Other labour market reforms facilitated creation of temporary, part-time and flexible employment and lowered employment costs.

Reforms to labour markets and social welfare programmes continued through the 1990s, though their goals evolved. The goal of social welfare reform shifted from "merely cutting costs to reducing the high level of inactivity"[12] and emphasised changing the incentives of employers. Reforms to disability insurance made benefits less generous and medical assessments more stringent, and created financial incentives to discourage putting employees on disability.[13] The sick pay scheme was privatised in two stages; by 1996, employers had strong incentives to use private insurers.

### … stimulating an export-led economic recovery and improvement in economic performance.

*The vicious circle was replaced with a virtuous circle of higher investment, stronger productivity growth and increased competitiveness.*

Despite delays and setbacks, progress was substantial, as shown in Box 1.2. The vicious circle of the 1970s was replaced with a virtuous circle of higher investment, stronger productivity growth and increased competitiveness, further stimulating exports and overall GDP growth. Relative unit labour costs (competitiveness)[14] stabilised, while substantial labour shedding caused a strong rebound in

### Box 1.2. Curing the Dutch disease: policy reforms have paid off in economic performance

Since the launching of major reforms to labour markets and the social security system in the 1980s, economic performance in the Netherlands improved relative to other OECD countries (see Figures 1.1 and 1.2 in Annex),[1] in part due to a rebound from relatively poor performance during the late 1970s and in part due to the fact that reform began earlier and has been more comprehensive than in comparable countries. Despite this improved performance some continuing weaknesses suggest potential gains from further regulatory reform:

- Since 1983 real GDP grew faster than average, narrowing the gap with the rest of Northwest Europe. Growth maintained surprising strength even through the European recession of the early 1990s (see Figure 1.1). A rebound in real consumption growth was delayed until the late 1980s but recovered and has been strong during the current recovery. However, growth in real wages and compensation remained low after 1985, which maintained competitiveness. Unit labour costs grew since 1983 at the lowest rate – by far – among eight comparable countries.
- Labour productivity in *manufacturing* rose at an annual average rate of over 3 per cent since 1983, and TFP growth remained robust, among the highest in the OECD. The success of regulatory and labour market reforms improved the integration of low-skilled workers into the economy by creating employment in the service sector, but meant that measured productivity growth in *services*, has been near zero in the 1990s among the worst in the OECD.[2]
- Consumer inflation has averaged under two per cent since 1983, consistently among the lowest in the OECD. However, price flexibility is below average for Northern Europe, and much lower than in the US. Relative prices tend to be much higher than in the United States.[3] In the 1990s the Netherlands ranked sixth in terms of relative price levels in both manufacturing and services compared to the group of eight comparable countries.
- Wage dispersion is relatively narrow compared with the United States and United Kingdom, and is similar to other European social market economies. Poverty rates are among the lowest of OECD countries studied, and income distribution is among the most equal.[4] But the distribution is widening, and the poverty rate is increasing slightly from a low level as the government reduces redistribution. These trends are moderated by increasing employment of low-skilled workers as a result of labour market reforms.
- Three synthetic performance indicators – dynamic efficiency, static efficiency and resource mobilisation – were constructed by the OECD Secretariat to measure aggregate performance. The Dutch manufacturing sector had much higher than average dynamic and static efficiency levels, ranking 2nd and 3rd compared to eight other countries. But its levels of resource mobilisation were much lower, ranking 7th. In services, all three measures were well below the OECD average and were near the bottom of the eight country rankings, performing the worst in dynamic efficiency. Individual services shows much better performance, however, suggesting that a few service sectors may limit overall performance. The aggregate data for the business sector highlight weaknesses in resource mobilisation, principally attributable to underutilisation of potential labour resources.

1. Figure 2, drawn from the OECD's ADB database, presents summary data comparing economic performance in the Netherlands with a eight OECD countries: the US, UK, Germany, France, Belgium, Denmark, Norway and Sweden. Figures 3-6, derived from the Regulation, Structure and Performance database, developed specifically for the Regulatory Reform project, set out measures of structural performance, particularly productivity measures.
2. These conclusions area drawn from the Performance database and from B. van Ark (1995), "Sectoral growth accounting and structural change in post-war Europe," Research Memorandum GD-23, University of Groningen, cited in OECD *Survey* (1996) pp. 80-82.
3. See J. van Sinderen *et al.* (1994), pp. 274-279, as cited in *Benchmarking the Netherlands* (1995). The analysis based on the Performance indicators is consistent with external studies which show substantial market rigidities, particularly in pricing. Van Bergeijk and Haffner (1996) provide a summary of a number of comparative studies of price flexibility in the Netherlands. They report that the Netherlands ranks in about the middle of OECD countries in terms of macroeconomic price flexibility, similar to levels found in other Continental European countries but higher than those found in the US or the UK. In particular, the Netherlands is characterised by high levels of inflation inertia and inflation is relatively unresponsive to deviations from trend GDP or GDP growth.
4. See Atkinson, Rainwater and Smeeding (1995).

productivity growth, restoring profitability and competitiveness to export sectors. Increased profitability and growing demand caused investment to rise. The resulting acceleration in capital stock growth sustained productivity growth even as employment increased. Exports rebounded and grew rapidly for the rest of the decade, stabilising the Dutch share in EU non-energy goods exports.[15]

The growth of private sector employment was perhaps the most impressive result of the reforms and has been the hallmark of the sustained Dutch recovery[16] (see Box 1.3). Despite the long-run reduction in unemployment, however, long-term unemployment and the rate of non-employment both remain high, as in many other European countries, imposing social costs, narrowing the basis for future Dutch economic prosperity, and reducing output and incomes as labour resources are underused.

These reforms had social costs as the distribution of household disposable income widened slightly and the poverty rate increased over the past decade.[17] This did not derive from changes in the earnings distribution, since the full-time earnings distribution remained unchanged from the mid 1980s on (*Employment Outlook, 1996*) and the same appears to be true for the distribution of household earnings and market income. The major causes appear to be

### Box 1.3. Labour market performance in the Netherlands

Assessment of labour market performance requires special comment as the interpretation of Dutch performance has been much debated. On one hand, reduction in unemployment rates has been among the best in the OECD. The Dutch economy created over 1 million net private sector jobs between 1984 and 1997, an increase of over 25 per cent, bringing unemployment down from its peak of nearly eleven per cent to around five per cent. Rapid growth of private employment more than offset an effective freezing of government employment.[1] By the mid 1980s the sustained growth in productivity permitted a resumption of real wage growth. Private sector employment growth has been slightly slower than the US rate, but faster than other continental European countries (Annex, Figure 1.1). Manufacturing employment declined less than average, and services employment growth was well above average. Declining unemployment was accompanied by higher rates of labour force growth than in other European countries. This has caused a steady fall in the non-employment rate.

On the other hand, the Dutch non-employment rate continues to be among the highest in the OECD (Figure 1.2*c*). Declining unemployment has been offset by increases in disability benefits, early retirement and subsidised employment programmes, and labour force participation rates among men aged 55-64 are low. Well over half of the jobs created have been part-time, and most have been in the service sector. Dutch workers on average have the lowest annual average working time per employee of any country. There are some indications that this is consistent with a preference for leisure, especially on the part of women and older workers,[2] but high marginal income tax rates make leisure an attractive option and the economy appears to continue to have some difficulty in generating full time jobs. The result is that a large share of potential labour resources is not utilised. Too, the Netherlands has a very high level of long-term unemployment. Over 50 per cent of unemployment is longer than a year.

1. Government employment grew at an annual rate of over two per cent in the 1970s.
2. OECD (1996), pp. 45-46.

reforms to taxes and social benefits and an increase in the number of two-income households. Counteracting these effects was increased employment for low-wage and low-skilled workers.

## SUSTAINING THE ECONOMIC RECOVERY THROUGH SUPPLY-SIDE REFORM

***Continuing problems suggest the existence of durable supply-side rigidities and weaknesses.***

Dutch economic performance has greatly improved since the crisis of the early 1980s, but continuing problems suggest the existence of durable supply-side rigidities and weaknesses. Strong economic performance in some areas has exposed microeconomic problems such as the sub-optimal performance of several service sectors. Limited employment creation in a number of service sectors in response to labour market reforms has revealed how regulatory and informal barriers to entry and price competition limit innovation and employment expansion. The difficulty of reducing social security transfers has forced attention to the efficiency of government services. Unemployment surged in the early 1990s as GDP growth slowed, showing the painful effects of price inflexibility: macroeconomic adjustments were made mostly through changes in quantities rather than prices.[18] Perhaps most importantly, despite fifteen years of labour market reforms, outflows from the unemployment scheme remain stubbornly low.

***Economic losses from poor regulation could be as high as 15 per cent of national income or 12 per cent of value-added.***

These supply-side weaknesses are an important drag on current performance, and reforms can boost future performance as competition intensifies in regional and global markets. The Netherlands Ministry of Economic Affairs has produced estimates of large losses in potential output: their studies (summarised in Table 1.1) found losses as high as 15 per cent of national income or 12 per cent of value-added. Moreover, most of these studies measure only static losses and ignore the losses to growth from dynamic innovation, yet experience from other countries has shown that dynamic losses are the greatest cost of a weak competitive environment.

Table 1.1. **Economic costs of sub-optimal allocation in the Netherlands: a summary**

| Study | Method | Period/year | Costs |
|---|---|---|---|
| Sinderen *et al.* (1994) | Counter factual (applied general equilibrium model) | 1994-2000 | 15% GDP level over six years[1] |
| Bergeijk *et al.* (1996) | Calculation of "non-tax" wedge | 1992 | 11-14% NNI[2] |
| Dijk and van Bergeijk (1997) | Average sectoral mark-up ratio | 1970-1990 | 8-12% turnover in manufacturing[3] |
| Haffner and van Bergeijk (1997) | Benchmarking in five sectors | 1997 | 2.2% in GDP level[4] |
| McKinsey (1997) | Benchmarking | 1997-2007 | 1.5% in GDP level[5] |

1. Based on a comparison of the tax reduction necessary to achieve a desired growth rate of employment of 2.5% per year in a flexible economy and in a rigid economy.
2. Costs of regulation.
3. Welfare loss in terms of Harberger triangles.
4. Welfare loss in terms of Harberger triangles.
5. Output loss.

Interest in supply-side tools has increased as the use of other policy tools, such as exchange rates and interest rates, has passed beyond the control of the Dutch government, or as in the case of fiscal policy, has been limited in the run-up to European Monetary Union. Regulatory reform is also supported by the positive demonstration effects of other domestic reforms. The success of labour reforms and the concurrent improvement in labour market performance made product market reforms easier and less politically contentious. The improvement in labour market performance may also help to absorb any short-term job losses that might occur as a consequence of regulatory reform in inefficient sectors. The overall employment consequences of regulatory reform are estimated to be positive, however.

**Sectoral regulatory reform was seen as a way to increase the adaptability and flexibility of the economy, and to promote growth.**

The programme of sectoral reform intensified substantially after 1994, following a change of government. The new government pursued regulatory reforms to reinforce and complement its programme of labour market reforms and macroeconomic adjustment. The new government viewed regulatory reforms as essential to *1)* increase the adaptability and flexibility of the economy to sustain international competitiveness; *2)* promote growth and innovation in the service sector and therefore enhance employment performance; and *3)* increase the efficiency of government services, so that fiscal consolidation would not compromise commitments to social welfare and a sound environment. Goals of importance to other countries, such as reducing the costs of inputs to the traded goods sector or reducing inflation, have been less important in the Netherlands.

Until 1994, reform focused on the public sector. Incorporation or privatisation of public sector services raised revenues (from privatisation proceeds[19]) and cut government expenditures (by reducing employment and increasing efficiency[20]). The programme pursued since 1994 went much further, and sought to increase competition in the economy, rationalise government-provided services by exposing the public sector to market forces, and eliminate sectoral barriers to competition in the private sector. Under the "MDW" (*Marktwerking, Deregulering en Wetgevingskwaliteit*) programme,[21] annual sectoral reviews produce recommendations for legislative and regulatory changes to promote competition (see Chapter 2). Today, EU reforms in electricity, telecommunications and air and road transport guide and stimulate domestic efforts, though the Dutch government has noted that in some cases it would have moved more quickly than the European reform schedule.

**The Dutch economy was characterised by widespread cartels, collusion and a low level of competition in non-trade sectors.**

***Collusion and interventionist regulatory styles prevented entry and limited competition.***

The Dutch economy was historically burdened by a high degree of collusion and interventionist regulatory styles that prevented entry and limited competition. Collusion was legally sanctioned: at one point, over 700 secret agreements were filed with

the government to fix prices, divide markets, control competition, or require exclusive dealing[22] (see Chapter 3). Price competition was limited, sometimes because of explicit collusion. Practices limiting competition have been associated with professional and industry associations in services in agriculture, trade, medical services, financial services and some sectors characterised by small businesses. These groups enjoy extensive self-regulatory powers, such as setting minimum standards for entry.[23]

Barriers to entry in the private sector were reinforced by the 1950s-era Establishment Law (recently revised), which established conditions, such as a general business education and specific competencies in business skills, for opening a new business. In quasi-public sectors, state intervention explicitly limited or prohibited competition, fixed prices, or both. In housing, entry into construction was relatively open but given the limited number of large construction companies capable of undertaking large projects, collusive tendering was rampant. The real estate market was itself inflexible as municipalities had the right to allocate housing, rents were tightly controlled and housing law favoured tenants. In health care, competition was and mostly remains non-existent.

**Reforms to the private sector are new and largely confined to services.**

*Most sector-specific reforms are recent, and largely in transportation and services.*

Most sector-specific reforms are recent, and largely in transportation and services. In road transport, entry and working hours were gradually liberalised over a period of years. By 1992, capacity and price controls had been eliminated and barriers to entry substantially reduced. In air transport the government gradually reduced its share in the main Dutch air carrier, KLM, to 25 per cent. In line with the EU Third Package, as of April 1997 all intra-EU routes were opened up to competition. This was recently expanded to permit cabotage (entry by foreign airlines on internal domestic routes), though this will have little effect in a country the size of the Netherlands. Competition was also enhanced by signing an open skies agreement with the United States.

*A highly symbolic reform was the liberalisation of shop opening hours.*

A highly symbolic reform was the liberalisation of shop opening hours. A minor change in 1993 increased weekly opening hours by 3 hours and slightly lengthened the working day. Substantial reform in 1996 allowed stores to open between 6 AM and 10 PM Monday through Saturday, and 12 Sundays per year at the discretion of the municipalities. The new rules also expanded the ability of petrol stations to sell retail products. Rules on the establishment of larger stores were also eased, but, as in Japan, the effect of this action may be offset if local governments act to inhibit expansion. Reforms to remove barriers to entry and pricing constraints in professional services are in various stages of consideration or implementation. In the legal profession, restrictions on prices, practice, and entry have been relaxed. Fixed fees for real estate brokers have been abolished.

**Regulated monopolies in electricity and telecommunications are opening to competition beyond EU reforms, but change is slower in sectors not covered by the EU.**

Electric power reform legislation passed in 1998 and is being implemented.[24] The new law allows competition in generation immediately and phases in retail competition between 1999 and 2007[25] (see Chapter 5). Substantial progress has been made in reforming telecommunications (see Chapter 6).

*Reform of public transportation has begun but is incomplete.*

Reform of public transportation has begun but is incomplete. The rail system was corporatised and split into three companies for passenger transport, freight and the rail network and a small new entrant has begun service on the Amsterdam-Harlem-IJmuiden line using old Belgian carriages. Direct setting of tariffs by the transportation ministry was replaced with a pricing band. Attempts to replace public monopolies in bus transport with public tendering for concessions has been held up by court challenges over labour issues. As of early 1999, a new law was nearly ready to submit to Parliament.

Reform of the health care system began in the 1980s. Initial attempts at cost control introduced budgeting and capitation systems for hospitals and other health care providers and liberalised pricing of medical equipment. More recent reforms have introduced some regulated competition between private insurers and permitted them to engage in some direct contracting with providers, including pharmacies, physical therapists and some general practitioners, but not physicians or hospitals. Competition among insurance companies is still largely confined to private insurance as inside the public system they are limited to providing the same basic package for virtually the same price, their only incentive is to lower their administrative costs.

**Performance in several highly regulated service sectors is poor, but competition has boosted performance in reformed sectors.**

*Productivity and efficiency appear to be correlated with the vigour of competition, or alternatively with the state's historical commitment to high quality.*

In general, sectoral performance measured as productivity or efficiency appears to correlate with the vigour of competition, or with the state's historical commitment to high quality, depending on the measure used. Performance in some infrastructure and service sectors compares favourably with other OECD countries in employment, output and productivity levels, and growth, and by a measure of X-efficiency,[26] but other sectors show considerable room for improvement (see Box 1.4 and Figures 1.3-1.9 in the Annex, which show Dutch sectoral performance compared to the rest of the OECD[27]).

*Lack of competition directly hurt consumers through higher prices, lower levels of product innovation and service quality, and mediocre levels of efficiency in several important sectors.*

Important sectors such as electric power, local public transport, and perhaps health care still suffer from inefficiency, high costs, excessive demand, or a combination of these. Inefficiency in these and other public sectors was confirmed in recent studies (summarised in Table 1.2) which found high levels of X-inefficiency in several public sector activities, ranging from six to 30 per cent. Lack of competition in these sectors directly hurts consumers through higher prices, lower levels of product innovation and service

### Box 1.4. Estimating the economic impact of regulatory reform

Regulatory reform can affect both sectoral and macroeconomic performance. Analysis of sectoral impacts draws on academic research. Microeconomic effects include benefits to consumers in terms of prices and service, impact on labour markets, changes in industry structure, competition and profits, and changes in costs and productivity, especially from innovations. Where possible, numerical estimates of sectoral effects are based on comparing what actually happened with an estimate of what would have happened without reform; where that is not possible, the observed change is reported. Quantitative measures for features such as service quality and innovation are generally not available, so key changes or anecdotal information are reported. The sectoral impact is summarised in Table 1.3. The impact of regulatory reform on macroeconomic performance is notoriously difficult to measure, and relies on estimates by other authors and previous estimates by the OECD.

The OECD's Regulation, Structure and Performance Database was also used to generate performance benchmarks of relevance to regulation (see Figures 1.3-1.9 in the Annex). Based on information from Member countries and other data sets, macroeconomic and sectoral indicators of economic performance have been developed by the Economics Department. Performance is defined as a multifaceted phenomenon (including static, dynamic and resource mobilisation dimensions). Synthetic indicators were constructed using multivariate data analysis techniques such as factor analysis. The database includes indicators for business sector manufacturing and service industries and for six specific service sectors (electricity, telecommunications, rail transport, air passenger transport, road freight and retail distribution).

quality, and mediocre levels of efficiency in several sectors. For example, government regulation of housing construction and siting interacted with collusion among construction companies to substantially raise construction costs.[28] Prices for notary services are estimated at 14 per cent above a free market price.

Wholesale and retail distribution activities are deeply affected by regulatory barriers to competition. Until recently, shop opening hours were restricted, greatly affecting consumer services. Zoning laws limited the establishment of shopping malls and large retail stores, and the area available for housing and commerce. These barriers were reinforced by entry hurdles in the old Establishment Law and, in some sectors, by supplier-retail price agreements and (EU) import restrictions.[29] Retail prices were unusually uniform, indicative of widespread price "guidelines" rather than intense competition.

Table 1.2. **Measured inefficiencies in public activities in the Netherlands**

| Activity | Period | X-inefficiency |
|---|---|---|
| Higher education (universities) | 1990-91 | 7-17% |
| Public libraries | 1976-90 | 21% |
| Drinking water provision | 1991-95 | 6-15% |
| Water purification | 1993 | 8-30% |
| Regional buses | 1991-94 | 35% |
| Nursing homes | 1984-93 | 14-30% |
| Home-care | 1989 | 6-20% |

*Sources:* R. Goudriaan *et al.* Economische effecten van concurrentieverstoring door organisaties met exclusieve marktrechten, ministerie EZ, 1998 and E. Dijkgraaf *et al.*, Mogelijkheden voor marktwerking in de Nederlandse watersector, ministerie EZ, 1997.

Table 1.3. **Status and expected impact of regulatory reform in sectors in the Netherlands**

| Sector | Status of reforms | Expected impact |
|---|---|---|
| Real estate brokers. (Dalen (95)) | Abolishment of fixed brokerage selling and buying fees; full application of competition policy. (Completed.) Easing of requirements for professional licensing and certification. (Proposed.) | Annual welfare loss of 207-291 m. guilders, increase in price differentiation, more variety in services. |
| Notaries (KPMG (94) | Gradual liberalisation of rates over a period of 3 years; liberalise establishment restrictions. (In process.) | Annual welfare gain of 360 m. guilders. |
| Lawyers (Kemp *et al.* (97)) | Abolishment of legally binding tariffs; easing of entry restrictions; increase possibilities for representation without lawyer. (Completed.) | 15% decline in rates and 15% increase in number of lawyers. |
| Pharmacies (Retail Wholesale Grp (94)) | Competition in buying and distribution of pharmaceuticals; insurers responsible for purchase. (Proposed.) | Annual welfare gain of 300 m. guilders. |
| Shop opening hours (CPB (95) and Gradus (96)) | Liberalisation of shop opening hours. (Completed.) Some restrictions, such as number of Sundays open remain. | Increase in employment of 7 000-15 000 persons; improved quality and availability of services. |
| Consumer credit (CPB (97)) | Increase competition and transparency on market for consumer credit. (Proposed.) | Reduction of risk premia, creating savings of 260-400 m. guilders. (10-15% of credit issued). |
| Buses (Commissie Brokx (94)) | Public tendering for bus lines with market share of parties limited to a maximum of 35%. (In process.) | Annual savings of 150-880 m. guilders. |
| Taxis (Heeres *et al.* (95)) | Liberalisation of entry restrictions, rates and abolishment of geographical market segmentation. (Proposed.) | 15% increase in passenger/km per capita; 10% increase in number of taxis; more variety in services. |
| Electricity (Haffner and van Bergeijk (97)) | Liberalisation of entry in generation; creation of separate legal entity for transmission; regulated TPA for transmission; gradual liberalisation of distribution; creation of electricity exchange. Maintaining universal service. (Legislation completed, regulations in process.) | Price decline of 11%, 11% increase in output; more innovation and customer service. |
| Water provision and purification (Dijkgraaf *et al.* (97)) | Introduction of benchmarking and yard-stick competition; maintaining quality. Benefits could be further enhanced by tendering specific projects. (Proposed.) | Annual savings of 220-670 m. guilders. |
| Airlines (Haffner and van Bergeijk (97)) | Implementation of EU-Third Package, partially liberalising and harmonising licenses (to start-up an airline), entry in intra-EU-routes and fares. Maintenance of quality and safety standards. (Completed.) Reform allocation of landing slots. (In process.) | Prices could decline by 4% and output could increase by 4%. |
| Road transport (Haffner and van Bergeijk (97)) | Liberalisation of cabotage, alignment of driving and resting periods with EU-standards. Maintaining quality and safety standards. (Completed.) | Prices could decline by 1% and output increase by 1%; estimated gains of 23-29 m. guilders. |
| Telecoms (Haffner and van Bergeijk (97)) | Full liberalisation of telecoms market while maintaining universal service standards. (Legislation completed, regulatory implementation in process.) | Prices could decline by 18% and output could increase by 40%. Declines in user charges of 25-40% to date. |
| Distribution (Haffner and van Bergeijk (97)) | Liberalisation of Establishment law, shop opening hours and zoning restrictions. (Completed) Abolish Establishment law (Proposed). | Prices could decline by 2% and output could increase by 5%. Increased entry of new firms. |
| Rental housing market (Nahuis *et al.* (97)) | Full liberalisation of rental housing market; alignment of rents to market prices. (In process.) | Welfare gain of 0.7-1.3 b. guilders. |
| Public tendering (Haffner and van Hulst (98)) | Increase public tendering of government services while maintaining service quality. (In process.) | Annual savings of 4-12 b. guilders. |

Uniformity at the microeconomic level helps explain the observed price inflexibility. Prior to recent reforms, productivity and efficiency in this sector were disappointing. Efficiency in retail distribution is difficult to measure, as data precede recent reforms in that sector. Performance measures supported the need for reform in the sector in 1994. Productivity levels, in terms of sales and value-added per employee and per establishment, were average to below average.

***The transportation sectors are the clearest example of the positive effects of competition.***

*Transportation* sectors are the clearest examples of the positive effects of competition. Competition has been stronger and longer standing in air and road transport, and the state has been strongly committed to high-quality, low priced (subsidised) rail service. These three sectors rank amongst the top countries in terms of total X-efficiency, and rail transport has the highest level of labour productivity in the OECD. These sectors also had good performance in labour productivity growth. Other public transport sectors tell a very different story. Comparative studies of bus and tram systems in Amsterdam and Stockholm show that Amsterdam has much higher costs and lower levels of driver productivity and utilisation of the capital stock. A study by Goudriaan *et al.* (1998) estimated X-inefficiency in regional buses in the early 1990s at around 35 per cent. For taxis, the number and geographic area of service are restricted. Limits on competition have made a taxi license worth NLG 200 000, or US$100 000 in the secondary market.[30]

*Electric power*, relatively inexpensive because of heavy reliance on natural gas as the primary fuel, has been dominated by a production cartel characterised by substantial production inefficiencies and excess employment (see Chapter 5). These inefficiencies have encouraged co-generation by industrial firms, leaving the cartel with substantial excess reserve capacity.[31] The result is a vicious circle: reduction in the centralised load, rising average costs, rising prices and greater incentives for independent production. In the electricity sector, where reform is just getting underway, performance is, at best, average on all productivity and efficiency measures.

In *telecommunications*, where the state monopoly was corporatised in 1989 and subsequently partly privatised, overall performance levels are reasonably good, but growth rates are not. The slow growth suggested a need for reforms to enhance dynamism and growth, that were undertaken between 1994 and 1998 (see Chapter 6).

***Relative prices reflected the vigour of competition.***

Relative prices reflected the vigour of competition: prices in more regulated sectors – electricity and telecommunications – were around the eight country average but relative prices in air transport were among the lowest. Prices in rail transport were also among the lowest, although this is also due to a high level of subsidies.

The *health care* sector is a complex mix of public and private insurance and regulation. Improving performance in the sector is currently a major focus. Despite a series of reforms, reliance on price to allocate goods or economic incentives to lower costs is limited. The number of hospitals is controlled and the government sets maximum prices, which effectively become actual prices; hospitals

are compensated for cost overruns if they exceed the government allowance. Similar arrangements are in place for general practitioners, though specialists operate on a fee for service basis. Fees for public health patients are based on a capitation system. Private patients are on a fee for service basis. Pharmacies are organised on a cartel basis and brand name drugs face hardly any competition from generic drugs. This regime is consistent with the objective of universal and equal service in which income does not determine the amount, speed or quality of care, but it has resulted in shortages and long waiting lists, particularly for hospital care, and a number of indicators suggest that costs are higher than necessary.

## ECONOMIC IMPACTS OF SECTORAL REGULATORY REFORM

### Positive results are already seen in some recently deregulated sectors like telecommunications and retail distribution.

Many regulatory reforms are too recent to have had measurable impact on economic performance. The exceptions are telecommunications deregulation and liberalisation of shop opening hours. The anticipated impacts of reform are summarised in Table 1.3.

*Prices for telecommunications equipment and long distance calls have fallen, and are expected to fall further, but prices for local business and residential service have risen.*

Reforms in telecommunications have had substantial economic impacts, as discussed in Chapter 6, though it is hard to disentangle the effects of reform from the dynamism of the sector as a whole. Prices for telecommunications equipment and long distance calls have fallen substantially, and are expected to fall further,[32] but prices for local business and residential service, among the lowest in Europe, have risen because cross subsidies from long distance calls were removed.[33] Employment in telecommunication increased by over 40 per cent over the past ten years, and user charges have declined by 20-25 per cent. Further improvements in productivity and efficiency should follow implementation of the 1998 telecommunications law. Labour productivity has historically been close to best practice in the OECD, so that only small gains (8-20 per cent) are projected, but capital productivity has been low and improvements of 30-50 per cent are expected, not including innovation. Further price declines of 18 per cent are expected (Haffner and van Bergeijk, 1997).

*Expansion of shop-opening hours has been a success.*

Expansion of shop-opening hours has been a success. Customer service improved and employment in the sector increased, although there have been complaints about longer working hours. Liberalisation increased overall retail sales volumes.[34] This occurred largely by shifting the competitive balance in favour of larger stores, especially food supermarkets, which gained in market share and profitability.[35] The biggest impact has been increased employment, especially among part-time workers, who are easier to hire and fire. Initial forecasts[36] projected an increase of 7-15 000 jobs (around 2-3 per cent), but actual increases in weekly hours have been much higher. Increasing employment is projected to cause a slight drop in labour productivity (2 per cent) but capital and total factor productivity are expected to increase as larger stores and bigger chains generate

economies of scope, particularly from the application of information technology to inventories and purchasing.

**Reforms have improved the overall regulatory climate and encouraged business formation.**

*Reform of competition policy is the most important change in the Dutch regulatory framework.*

Reform of competition policy is the most important change in the Netherlands' regulatory framework (see Chapter 4). This reform reverses the long-standing policy of tolerating collusion and cartels.[37] Beginning in 1993, a series of measures prohibited price fixing, market division, and collusive tendering. Reform culminated in the comprehensive 1998 competition law, based on the "prohibition" approach of EU competition law. One result of these efforts is greater competition in areas like construction bidding, where agreements to rotate winning bids are now forbidden (although some joint tendering is still permitted).[38]

*Other measures affecting competition have improved the climate for small and medium-sized enterprises.*

Other measures affecting competition have improved the climate for small and medium-sized enterprises. Overall administrative burdens on business have been reduced by an estimated 10 per cent, though the cost-savings are unclear. Reforms eased the burden of environmental licensing on SMEs and on certain sectors. The Establishment Law of 1996 replaced a demanding set of requirements for starting a small business with a looser set of general conditions, de-emphasising formal training.

## ANTICIPATED EFFECTS OF FURTHER SECTORAL REFORMS

**Expansion of market forces in public services, transport, and health care services promise substantial gains for consumers.**

*Product market competition has improved as a result of the reform process, but further reforms could produce substantial gains in…*

The level of product market competition in the Netherlands has improved as a result of the reform process, but further reforms could produce substantial gains. The agenda of uncompleted reforms is long. Public services and regulated monopolies could benefit from additional initiatives to introduce competition.

*… natural gas and electricity…*

– In natural gas and electrical power, completing privatisation and the separation between production and transmission are important steps.

*… public transport...*

– The benefits from tendering of concessions for public transportation are already clear from initial attempts. This should proceed; indeed, tendering could be extended to other services, such as water treatment and waste disposal.[39]

*… air transport…*

– Competition in air transport could be increased by replacing the current system of grandfathering airport landing rights with an auction system.

*… health care…*

– In the health care system the authorities are evaluating a number of potential reforms including: allowing insurance

companies to contract directly with hospitals and physicians, shifting the burden of cost-overruns from the government to hospitals and deregulating prices for hospital care and other medical care products. The government is committed to several measures to increase the role of the market, including ending the monopoly of pharmacists on the distribution of medicine and eliminating a special insurance scheme (WTZ) for bad risks, shifting most of them back to public health system.

*… water supplies.*

– Introduction of benchmarking and tendering in water purification and provision show large potential gains.

*Limits on the number of taxi licenses and geographical limitations on service areas should be removed.*

Reform in other service sectors would produce important gains. Limits on the number of taxi licenses and geographical limitations on service areas should be removed. Remaining controls on pricing of professional services, as well as unnecessary barriers to entry can be eliminated. A law liberalising notary services was introduced in 1994 and was approved by one chamber of Parliament in 1998: full approval is still needed. Further reforms in real estate brokerage are necessary to ease the professional certification requirement and increase entry, and the authorities should examine the need to ease professional licensing requirements in other sectors.

### Significant price drops and gains in consumer welfare are expected in other sectors undergoing reform

*The Netherlands is likely to see large price reductions after reform.*

Large price drops usually experienced in other countries following sectoral reform are likely to be replicated in the Netherlands. Prices for medical equipment such as wheelchairs and hospital beds have already fallen by nearly 75 per cent and there have been declines in prices in road and air transportation as well, though small additional gains are projected there as well. Studies by Haffner *et al.* (1997, 1998) and others project price declines of 10-15 per cent for electric power, legal and real estate brokerage services (see Table 1.3). While prices for public transportation are already low, substantial declines are expected in costs, reducing the need for subsidies. A recent tendering for a concession resulted in a bid 40 per cent less than current costs.

*In pharmacies, consumer credit, taxis, water treatment and distribution, gains from reform could exceed 300 million guilders annually.*

Large gains in consumer welfare are expected in a number of sectors for which new reforms have been proposed. In the sectors of pharmacies, consumer credit, taxis, water treatment and distribution, gains are estimated to exceed 300 million guilders, only 0.05 per cent of GDP but a substantial proportion of sectoral output.

### Productivity has already increased in infrastructure industries and more improvement is expected in these and new sectors.

*Reform should lead to productivity improvements, particularly by stimulating innovation and diffusion of new services.*

Productivity levels in the Netherlands are already quite high, particularly in manufacturing and transportation, but in several other sectors they are close to or even below average OECD performance levels. Reform should lead to further improvements, particularly in

dynamic efficiency which has been lagging in many sectors, inhibiting the innovation and diffusion of new services. In telecommunications gains in labour productivity of up to 20 per cent can be expected.[40] Similar gains are projected in some parts of public transport. In electric power labour productivity has grown by 40 per cent since 1994 in anticipation of reform and an additional 10 per cent increase is forecast following actual deregulation. Larger gains are projected in terms of capital productivity: in telecommunications gains of 30 to 50 per cent will result from the introduction of new services and in electric power capital productivity is expected to increase by 25 per cent as excess reserves are eliminated. Similar gains are expected in local public transport and road transport, if restrictive work practices are changed.

**Entry of new firms is expected to increase while inefficient producers are driven out, resulting in a net increase in competition and decline in rents and profits.**

*More intense competition will force adjustments for inefficient firms, but result in long-term gains.*

More intense competition can impose initial adjustment costs on existing competitors, as new entry drives out inefficient producers, but generate long-term gains. In air transport[41] and telecommunications, though, new entry has been so limited that it has not had a significant effect on existing suppliers. In air transport, there has not been new entry despite the introduction of cabotage, possibly because of constraints on airport slots. In telecommunications, entry occurred in all areas of telephony, but the former monopoly provider, KPN, continues to dominate the market, accounting for nearly 100, 80 and 60 per cent of local, long-distance, and mobile calls, respectively. But entry is expected to continue,[42] tariffs in mobile telephony are expected to drop as much as 50 per cent, and overall profits in telecommunications are expected to fall by 5-20 per cent. In retail, competitive pressures have already increased on small stores. The same is expected to happen in electric power[43] and in most services such as taxis and in notaries, lawyers and other professional services.[44] The decline in prices in other professional services should result in a decline in implicit rents or profits.

**The employment effects of regulatory reform are expected to be largely positive, but will partly depend on further labour market reform.**

*Regulatory reform needs to be accompanied by reforms to labour markets and social security.*

Regulatory reform could significantly boost growth and competitiveness, and lead to greater demand for qualified workers. This demand may be difficult to fulfil, since open unemployment is already quite low and skill bottlenecks are emerging in parts of the economy. Regulatory reform-induced growth could therefore lead to wage and inflationary pressures, unless a larger proportion of the working-age population can be reintegrated in the workforce. This will require, amongst others, further reforms to the social security system, active measures to reintegrate the large stock of disabled workers, and further upskilling of the workforce.

***The effect of sectoral reform on employment is expected to be positive, as large gains in most service sectors will outweigh projected losses in electric power.***

If these conditions can be met, the effect of sectoral reform on employment is expected to be positive, as large gains in most service sectors, particularly in retail distribution, telecommunications and professional services, will outweigh projected losses in electric power. Employment in telecommunications has already increased by over 40 per cent over the past ten years. This pace is expected to continue as reform continues and new products and services are introduced. The sector where a large decline is expected is in electricity, where excess employment is estimated at 25-30 per cent. Even in this sector, the experience of other countries has shown that the development of new services and markets, such as financial futures, could stimulate employment growth in the long run. The overall impact of regulatory reform should go beyond these sectors, however, and could significantly enhance employment performance. While regulatory reform may thus lead to shifts in the employment composition of the Dutch economy, the overall employment impact will be positive.

*Chapter 2*

# GOVERNMENT CAPACITY TO ASSURE HIGH QUALITY REGULATION

The shift to market-oriented regulatory policies and instruments has required major reform of the Dutch public sector itself. This is not a question of simple downsizing, but of finding new ways for the government to sustain effectiveness in dynamic markets. Since regulations will continue to be necessary to carry out public policies, new institutions are needed to enable the public sector to regulate better. The key challenges in the Netherlands with respect to regulatory quality are *1)* improving the transparency and responsiveness of the regulatory system as a whole, and *2)* upgrading the quality of social regulations to deliver public services such as environmental protection and health and safety with the best use of the country's resources.

## Reform of supply-side policies required a different relationship between state and market.

***The state has shared sovereignty over making and applying public policy with organised market interests.***

Patterns of corporatist interest representation can readily be seen in economic and social policy-making in the Netherlands: policy stability, orientation toward common interests, and a consensual or problem-solving style of decision-making (Visser and Hemerijck, 1997). One visible aspect of this administrative style is that relations between the state and organised business and labour are embedded at political and administrative levels. In many areas, the state has shared sovereignty over making and applying public policy with organised market interests. Tripartite advisory bodies are attached to each ministry. A large number of industrial and professionally based bodies grew up over decades, and many were delegated regulatory functions. This complex of private organisations formed the framework for a pervasive set of cartel arrangements (see Chapter 3). Recent reforms have done much to reverse this proliferation, though concerns over the potential anti-competitive use of delegated powers persist.

***Though the Dutch corporatist model has been praised for its capacity for flexible adjustment, rigidities and inefficiencies have grown up.***

As noted in Chapter 1, analysts have praised the Dutch corporatist model for its capacity for flexible adjustment to changing external conditions.[45] The Dutch approach to regulation has produced what is seen in the Netherlands as good protection for consumers, and regulation has been an active tool for distributional policies in a society that highly values equity. Some

aspects of the consensus approach can facilitate good regulation and reform. Sharing policy functions with market interests is said to improve compliance and give government better access to information, improving the basis for policy-making, while use of professional bodies as regulators may offer benefits in terms of cost savings and expertise.

***Policy responsiveness is poor, and special interests have too much influence over some regulatory decisions.***

Rigidities have, however, grown up, and such arrangements can easily lead to uncompetitive behaviour, and harm consumer interests they were supposed to protect. In recent years these structures have been criticised as unsuited to contemporary economic, social, and administrative realities, and as contributing to regulation that is complex, detailed, non-transparent, and closely tied to narrow interest groups.

- They have dampened policy responsiveness. On average, four years is required to introduce and adopt new legislation (an improvement over a process that previously took an average of seven years), a considerable fraction of which is traditionally spent in consultation.
- Advisory bodies have too often functioned as defenders of narrow self-interests, rather than as providers of expertise. The potential for abuse by "insiders" seeking market advantages is high.
- The search for consensus has promoted regulatory complexity, as additional details are added to balance competing interests, and resulted in inefficient, ineffective or even legislation that is impossible to implement.
- Corporatist and cartel-like structures established under the Industrial Organisation Act are inconsistent with market openness in services, and EU single market and anti-cartel policies.
- Changes in Dutch society, including its increasing pluralism and a decline in union membership, meant that the representativeness and legitimacy of the tripartite structures diminished. The Dutch Government stated in 1993 that "The desired social base cannot always be obtained by consulting advisory bodies".[46]

**New regulatory approaches based on transparency, empirical analysis, and competition principles are helping regulators achieve public policies more efficiently in competitive markets.**

***The Dutch administration is moving away from regulatory processes dominated by "insiders" toward more transparent and empirical processes.***

Reforms are moving the Dutch administration away from regulatory processes dominated by "insiders" toward more transparent and empirical processes, while attempting to maintain the benefits of consensual decision-making. This difficult balance is at the core of many of the tensions of the reform process today. (Ironically, it is the exact converse of the reforms needed in the United States today, that is, away from adversarial and arms-length processes toward more co-operative and flexible forms of regulation).

The current regulatory reform program in the Netherlands, which began in 1994 and was extended in 1998, is by far the most ambitious of many years of reform efforts. As noted in Chapter 1, the object is to achieve "a new balance between protection and dynamism" by increasing competition and regulatory quality. The multi-faceted "Functioning of Markets, Deregulation and Legislative Quality Programme" (MDW) seeks to improve competition through regulatory reform, reduce regulations to "return to what is strictly necessary" and improve regulatory quality through rigorous *ex ante* impact analysis.

***The Dutch reforms focus more than do most countries on indirect regulatory impacts on competition, consumer choice, and welfare.***

Reflecting its connection to the competition office of the Ministry of Economic Affairs, the Dutch reforms focus more than do most countries on indirect regulatory impacts on competition, consumer choice, and welfare. Direct costs and benefits of social and economic regulations are not stressed, perhaps because they are not well-known. There are indications, however, that they may be in the same magnitude as in the United States, or around 10 per cent of GDP. For example, research by the Dutch National Institute of Public Health and Environmental Protection estimated total direct costs of environmental protection at 2.7 per cent of GDP in 1995, including public and private expenditures,[47] not far different from US costs. Dutch benefits from these expenditures were not similarly quantified (see Box 2.1).

**The Netherlands ranks high among OECD countries for its progress in improving capacities to issue quality regulation.**

***Much of the machinery for good regulation is in place.***

The Netherlands has installed much of the formal administrative capacity needed to produce high quality regulations and to promote reform. New disciplines have been built into the administration. Institutions with responsibility and incentives for good regulation – with accountability at the highest political levels – have been created to make things happen. Quality standards based on good regulatory principles; decision tools such as regulatory impact analysis; and more transparent processes such as open public consultation have been adopted. Reductions in administrative burdens have decreased costs. Innovative policy instruments are used more often than in most OECD countries.

***The combination of competition, deregulation, and good regulatory quality can be an effective policy mix for improving economic dynamism, while maintaining protection.***

As a result, in most formal aspects of government capacities, the Netherlands ranks high among OECD countries (see Figure 2.1). The combination in the MDW program of competition, deregulation, and good regulatory quality shows the potential to be an effective policy mix for improving economic dynamism, while maintaining protection. Moreover, the reform programme is itself extraordinarily dynamic, the debate inside and outside the administration is well-informed and vigorous, and the search for better solutions continues through a pragmatic results-oriented approach. This flexible pragmatism is perhaps the greatest strength of the Dutch reformers.

### Box 2.1. Managing regulatory quality in the Netherlands

*Ensuring regulatory transparency*

- In January 1994 the General Administrative Law Act came into effect, considerably enhancing the transparency of administrative rights.
- There is no standardised procedure for consultation. Consultation on proposed regulations takes place through permanent advisory bodies attached to each ministry, a network of other advisory bodies organised along the tripartite principle. These are increasingly supplanted by informal consultation conducted at the discretion of Cabinet and individual ministries. In some cases notice and comment procedures are used.

*Promoting regulatory reform and quality within the administration*

- The current reform policy establishes clear political accountability. A Ministerial Committee chaired by the Prime Minister directs the reform process. Members include the Ministers of Justice and of Economic Affairs (also responsible for competition policy), considered the "co-ordinating Ministers" for the MDW programme.
- Day to day centralised oversight and quality management is conducted by the Ministries of Justice and Economic Affairs. The two ministries work with a high level and independent Civil Service Commission with two functions: *1)* identify priority areas for reform under the "special topics" element of MDW and prepare proposals for the Ministerial Commission; and *2)* appoint *ad hoc* working groups to prepare specific proposals.

*Adopting explicit standards for regulatory quality*

- Explicit standards for regulatory quality are adopted in the "Directives on Legislation" developed by the Ministry of Justice since 1972. These binding rules for all ministries are formally issued by the Prime Minister. They require that the need for regulation be justified; objectives of regulation be clearly defined; regulations should be clear; the most cost-effective regulatory or non-regulatory alternative should be chosen; indirect effects, including competitiveness, investment climate, etc., should be considered; and the regulation must be enforceable.

*Assessing regulatory impacts*

- Regulatory impact assessment has been required in the Netherlands since 1985. A significant overhaul of the programme was implemented under the MDW programme. Today, RIA is broad ranging, covering a proposal's impacts on business and the environment, as well as assessing its feasibility and enforceability. In 1997, instructions were published in the form of a "Business Effects Test (BET)" checklist.

*Reviewing and updating regulations*

- Each year, about ten in-depth reviews of specific areas of legislation are proposed by a Civil Service Commission following consultations with interested parties and are approved by the Ministerial Commission. Working groups conduct the reviews and recommend reforms.

*Reducing administrative burdens*

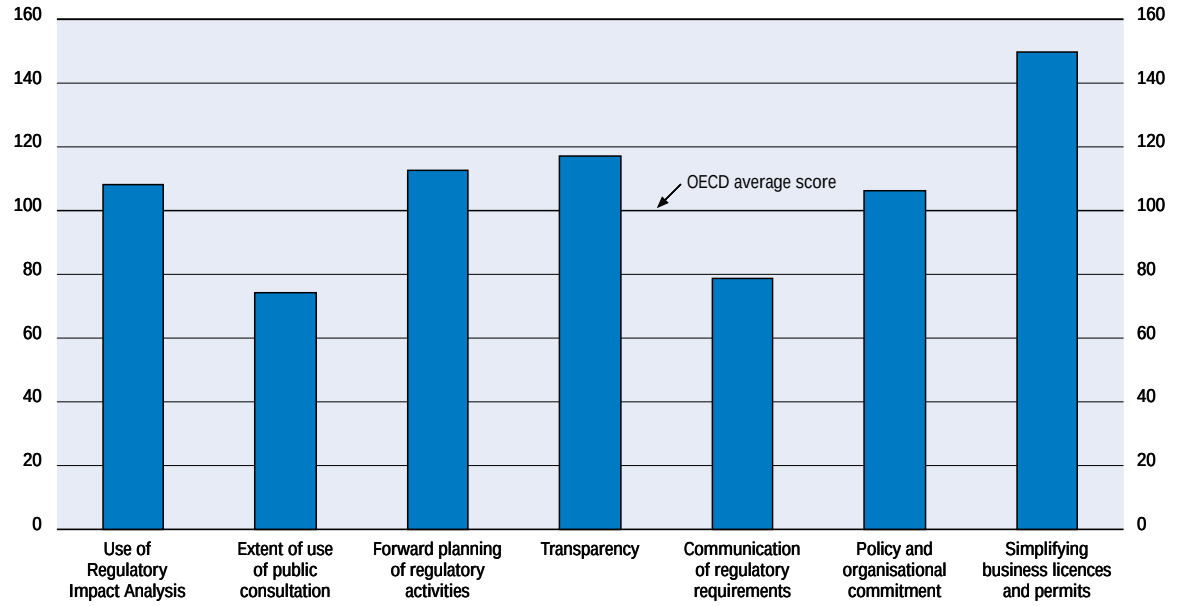
- A programme to reduce administrative burdens has been part of MDW since 1994. In 1993, it was estimated that aggregate costs of administrative burdens was 13 billion Dfl. A target of reducing costs by 10 per cent was set. This was judged to have been met in 1998 and a new target of a further 25 per cent reduction is being considered for the second stage of the programme. The programme contains a number of elements including reviews by administering agencies, consultations with a panel of entrepreneurs and technology based projects.

**Oversight and promotion of regulatory reform are among the most developed in the OECD.**

***Mechanisms for reform are cross-cutting and independent, and are consistent with OECD recommendations.***

Mechanisms to promote reform inside the administration are needed to keep reform on schedule. To manage the large and complex regulatory reform program, the Netherlands has established a series of oversight bodies. The MDW programme is managed by a

Figure 2.1. **Indicators of strengths and weaknesses in the Netherlands regulatory system (This synthetic indicator measures Dutch scores against the OECD average, measured as 100)**




*Note:* These indicators measure the normal aspects of national regulatory reform policies. They do not directly measure the intensity and effectiveness of application of those policies, and hence may not be a good proxy for results.
*Source:* Public Management Service, OECD, based on information from OECD countries, March 1998.

Ministerial Committee, chaired by the Prime Minister. A high level Civil Service Commission identifies reform priorities and appoints working groups to prepare proposals. The Commission strengthens central direction and reinforces capacities to cut across sectors and policies, and take an independent approach to reform. The inter-ministerial structure allows for "thematic" government-wide reviews and integrated reform recommendations. This is consistent with the recommendation in the *OECD Report on Regulatory Reform* for "comprehensive" reform.

The day to day running of MDW, including the operation of a "helpdesk", is by the Ministries of Justice and Economic Affairs, with assistance from the Environment Ministry. This allows a multi-disciplinary approach to regulatory quality. The Ministry of Justice also reviews and negotiates with ministries on draft laws prior to submission to Cabinet, using regulatory quality standards. This is an important quality control mechanism. Enforcement and enforceability issues are also reviewed against a checklist that is an innovative and promising approach to the difficult issue of improving compliance.

**The MDW and other reforms began slowly but should now accelerate in terms of concrete results.**

***Many regulatory areas have been reviewed, though progress in concrete change is slow.***

The *OECD Report on Regulatory Reform* recommends that governments "review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively". In the

Netherlands, processes are underway to review and revise or eliminate many existing regulations. Much review activity has been undertaken. Progress in making actual changes has been slower. As the Chair of the Dutch Social Economic Council observed, "We are better at making laws than at revising them".[48]

Reviews of regulation are carried out under the MDW programme and can focus on a regulatory "theme" or an industry, activity or profession. Review proposals are developed by the Civil Service Commission and approved by the Ministerial Committee, though the actual work is carried out by *ad hoc* working groups. Areas for review are selected according to their economic significance, potential for significant reforms, political considerations (including timing) and the balance of the overall package. Affected parties are consulted in the reviews. Social and economic regulations have been reviewed, such as workplace health and safety, environmental permits, hospitals, product liability, food regulation, the electricity industry, taxis and shop hours.

***It takes a long time for reform proposals to be implemented. In effect, the Netherlands has constructed a new highway to speed traffic, but most of the cars are stuck at the tollbooths.***

In the areas where reforms have been identified, however, implementation of proposals has been very slow, reducing the benefits of reform. By April 1998, only three significant reforms had been completed: the substantial (though still partial) liberalisation of shop hours; the first stage of an ongoing programme to reduce the number of businesses subject to environmental licensing; and removal of lawyers' monopoly rights to represent clients in legal proceedings. By March 1999, a further six had been implemented. Officials expect many more of 36 proposed reforms to emerge in the near future, but it has been as if the Netherlands constructed a new highway to speed traffic, but most of the cars were stuck at the tollbooths.

**Reforms to public consultation have increased the potential efficiency and responsiveness of the regulatory system.**

***Public consultation is extensive, but has changed due to dissatisfaction with inefficiencies, to improve safeguards against excessive influence by interest groups, and to reflect trends toward a more pluralistic society.***

Transparency is essential to ensure an accessible and neutral regulatory environment, but processes such as consultation on draft regulations must be done well to guard against undue delays and influence by special interest groups. Public consultation in the Netherlands is extensive, but has rapidly changed in recent years due to dissatisfaction with its inefficiencies, to improve safeguards against excessive influence by interest groups, and to reflect broader trends toward a more pluralistic Dutch society. The most radical changes were a reduction in the number of advisory boards from over 470 to one per ministry and elimination of the legal requirement that ministries consult with advisory bodies.

***A major overhaul of virtually all aspects of consultation are consistent with an international trend toward more transparent and accessible regulatory processes.***

These reforms represent a major overhaul of virtually all aspects of consultation and are consistent with an international trend toward more transparent and accessible regulatory processes. By giving the administration greater flexibility on who to consult and when, these reforms seek to enhance the value of consultation in producing data and expert opinion, to streamline the process, and to reduce delays. This will produce important benefits for the quality of regulation, in

part because consultation is today occurring within the context of more rigorous controls on regulatory quality. In fact, consultation is seen today as an input to quality decisions rather than a search for consensus, a major cultural change.

An issue that should be closely watched is the tension between flexibility and accessibility. If ministries have too much discretion to pick and choose who will participate, the risk is great that "insider" groups will gain too much access once again. The OECD has recommended that "all interested parties" should have the opportunity to present their views, and this will require systematic and predictable consultation processes of some kind (OECD, 1995). Too, dangers of a renewed proliferation of advisory boards are already becoming apparent.

**Dutch policies are relatively innovative in the use of flexible and market-oriented instruments, but expansion could deliver large gains.**

*The Dutch administration has considerable experience with co-operative forms of regulation and market incentives, and the results appear positive.*

Many OECD countries are expanding use of innovative policy instruments that are flexible and market-oriented. These approaches spur, rather than block, innovation and adjustment in the economy. Given the rigidities and delays in the Dutch policy system, such instruments are of particular value. The Dutch administration has considerable experience with some alternatives, primarily co-operative forms of regulation related to corporatist traditions, and market incentives. The results appear positive with respect to cost-effectiveness. Ironically, alternatives are used partly due to pressure on the administration to implement policies more rapidly than permitted by arduous regulatory processes. The National Environment Policy Plan states that "The long gestation period and lack of flexibility mean that legislation is increasingly perceived as an obstacle to social renewal".[49]

Tradable permits are used in the Netherlands mainly in agriculture – fishing quotas, manure spreading rights, and milk quotas. A "green energy permits" scheme in the energy sector could significantly reduce costs (see Chapter 5). Green tax reform is a major vehicle for integrating economic and environmental policy, and is a major piece of regulatory reform. Environmental taxes introduced recently are revenue neutral (for example, revenue from the "regulatory tax on energy" is redistributed as reduced income taxes and social security contributions). Income tax deductions are given for commuting via public transport. The use of covenants in the environmental area is widespread (see Box 2.2).

*If alternatives to traditional regulation are to make further headway into the Dutch policy system, a clearer leading role is needed, supportive of innovation and policy learning.*

Yet in most policy areas the use of innovative instruments is not increasing, and the reform programme does not adequately encourage the use of market-oriented approaches. The Prime Minister's directives encourage the use of alternatives, but there is no operational guidance on the use of alternatives. The regulatory impact analysis programme does not require that feasible alternatives be identified and assessed for cost-effectiveness. If alternatives to traditional regulation are to make serious headway into the

### Box 2.2. Environmental covenants in the Netherlands

Covenants, used in the Netherlands since the 1980s, are employed in most major policy areas. A survey in the early 1990s produced a list of more than 150 covenants in force, and the numbers have grown. Their largest use is for environmental protection, in areas such as basic metals, paper and cardboard production, dairy products, batteries, PET bottles, CFC and phosphate use, and wastes.

The covenant is a negotiated agreement between a ministry and industry group for specific actions to be carried out. Covenants can have a fixed or indefinite duration. The majority of covenants are concluded between a ministry and an industry umbrella organisation (usually in sectors dominated by large firms) and bind all members of the organisation. Hence, the influence of the covenant can be far-reaching. The roots of this type of covenant in Dutch corporatist traditions are evident. Often characterised as "voluntary agreements", some covenants are in fact concluded under civil or administrative law and are legally enforceable.

For producers, the attraction of covenants is that they are negotiated with individual industry sectors (unlike most legislation) and the process allows more significant input. Convenants are seen as potentially more responsive to industry needs in terms of means of implementation, scheduling of requirements, and so forth.

There are some concerns, however. The making of covenants is less open to third parties than is the legislative process, and concerns about legitimacy remain. Moreover, while 1995 Cabinet guidelines require consideration of whether parliament ought to be involved, there is no requirement that this occur. Finally, there are concerns about the possible effects of these industry agreements on competition.

*Source:* Bastmeijer, Kees (1997), "The Covenant as an Instrument of Environmental Policy: A Case Study from the Netherlands," published in Huigen, Hans, ed. (1997) *Co-operative approaches to regulation*, PUMA Occasional Papers No. 18, OECD, Paris.

Dutch policy system, a clearer leading role – supportive of innovation and policy learning – must be taken by reform authorities.

**The Dutch program on regulatory quality, while ambitious, has not delivered as much as expected, due to problems with implementation, gaps in coverage, and slow decision processes.**

***A sustained period of attention to implementation of current proposals, embedding the reforms in the public administration, and filling gaps is needed.***

Substantial investments in promoting quality regulation have not yet adequately paid off in practice. This is not unexpected, given the time lag needed to see results from such an ambitious and far-reaching reform programme. A sustained period of attention to implementation of current proposals, embedding reforms in the public administration, and filling gaps is needed to complete the reforms of recent years. There are several priority areas for attention:

- Principles of "good regulation" adopted to guide reform are comprehensive in coverage and well-conceived and, on paper, compare favourably with quality standards recommended by the OECD. However, though they are formally binding on ministries, the Ministry of Justice has concluded that the principles are not sufficiently operationalised to be effective. This is possibly due to limited control over their use.
- Similarly, assessment of the regulatory impact analysis programme against OECD best practices suggests that much of the framework for good RIA is in place, but that significant

elements are missing. As a result, the RIA programme has not been very effective in producing reliable data that can increase the cost-efficiency of regulation. There is also a lack of systematic consideration of alternatives, of training programmes for regulators, of integration of RIA into consultation processes, and of integration of RIA with the policy-making process. These areas should be addressed if regulatory analysis is to be effective in improving regulatory quality in the Netherlands.

– A critical gap relates to the OECD's recommendation that regulations should produce benefits that justify costs – *i.e.* that they should enhance social welfare. While the Prime Minister's directives require consideration of proportionality (a requirement mirrored in European legislation which forms the basis for much Dutch law) the Dutch framework for regulatory analysis includes neither consideration of proportionality nor a benefit-cost test, no public testing of conclusions, and no opportunity for challenge.

– New forms of consultation with affected members of the public are needed to replace the tripartite advisory bodies. New practices are still developing, and are not systematic nor always accessible. The risk of new forms of regulatory capture will remain high until consultation is based on a consistent and transparent framework.

*Chapter 3*

# THE ROLE OF COMPETITION POLICY IN REGULATORY REFORM

**Competition principles are central to the regulatory reform programme.**

***Dynamic and adaptive capacities of the Dutch economy are stimulated by fundamental competition policy reform.***

The strengthening of Dutch competition policy, which culminated in the new Competition Act coming into force on 1 January 1998, is of great importance for the implementation of the regulatory reform programme. Chapter 1 described how the first stages of reform in the 1980s set the stage for a re-invigorated market economy by making more resources available to the private sector and by relaxing constraints that inhibited flexible, efficient use of labour. Those reforms revealed the need for others, as they uncovered other rigidities. Efforts to improve adaptability and promote growth turned to regulations that directly affect how markets function. In 1994, the new cabinet included competition principles as a fundamental element of the MDW programme, described in Chapter 2. In parallel, there has been a revolution in the Netherlands' competition policy. The new competition policy is a central element of a "cultural turnaround" needed to ensure continued Dutch economic health in regional and global economies.

**Competition and entrepreneurship had been hampered by policies intended to promote distributional and small business concerns.**

***The Netherlands tolerated so many anti-competitive agreements that the country became known in the 1980s as a "cartel paradise."***

The old economic Competition Act was based on the so-called "abuse system", leading to the Dutch reputation as a "cartel paradise". Much of the Dutch economy, in sectors such as construction, utilities, financial transactions, transport, retail trade, and consumer and professional services, was insulated from imports through practices such as protection of established positions. At one point, over 700 agreements were filed with the government to fix prices, divide markets, control competition, or require exclusive dealing. Such agreements were widespread in wholesale and retail distribution. A 1992 article claimed that 40 per cent of the important cartel cases in EC competition enforcement were Dutch.[50]

Continuity, tradition, and alliances in the developing welfare state had taken priority over risk-taking and entrepreneurship. Concerns about fairness, distribution, and small business are strong

elements of the Netherlands' social traditions, and probably delayed the implementation of effective competition policy.

***Domestic cartels and concentrations of economic power led to high prices and price rigidity.***

Restricting competition increased prices. Chapter 1 documents the higher costs and prices in sectors where agreements or regulations constrained competition. Lack of competition also helps explain the unusual rigidity of prices in the Netherlands. The difficulty of adjusting to economic changes by changing prices forced the Dutch economy to adjust by more painful means, contributing to structural problems of employment and low growth.

**Mounting concern about supply-side problems, and European-level policies, prompted more attention to the inadequacy of competition policy and tools.**

***In responding to EU law and to supply-wide problems, the Dutch stepped up enforcement under the existing law…***

As the government began to review and correct anti-competitive regulation, enforcement of the existing competition law was stepped up and extended to liberal professions and informal agreements. The government tried to ban the most harmful kinds of cartel behaviour under the existing legal structure. In 1993, price fixing was prohibited, and in 1994, market division and collusive tendering were banned.

***… followed by a completely new competition policy modelled on European law.***

Establishing a strong basis for competition policy, however, required fundamental legal and institutional changes. The government moved to create a completely new legislative basis for competition policy, based on European law. This law became effective on 1 January 1998. On the same date, a new enforcement agency, the *Nederlandse Mededingingsautoriteit* (NMa), began work. The new law and new virtually independent enforcer embody the Dutch determination to make a clean break with the past and a clear announcement of the high priority now placed on competition policy (see Box 3.1).

### Box 3.1. Self-regulation by industry and trade organisations in the Netherlands

In Dutch corporatism, co-operation is institutionalised through self-regulatory institutions for agriculture, trade, and smaller service businesses. Thirty-eight "statutory industrial organisation bodies", or PBOs, are composed of representatives of business organisations and unions. They are most significant in sectors dominated by small businesses, though some of them include very large firms. The half-million enterprises covered by PBOs employ about a quarter of the people working in industry, trade and agriculture.

Authorised by the Industrial Organisation Act of 1950, the PBOs have legal powers to regulate in the general interest and to promote sectoral interests. Their regulations are subject to approval by the Social and Economic Council (SER), composed of business, trade union, and experts, and the government (and the European Commission, if they might interfere with EU policies). Regulations can cover quality control and inspection, disease prevention, additives, import-export processes, and consumer information. PBO regulations may implement national and EU policies.

The Industrial Organisation Act requires that PBOs not impede fair competition. The SER is responsible for authorising PBOs. It plays the most active role in supervising their regulations and in assuring that their formation and operations conform to the principles of the Competition Act, although the NMa can take enforcement action if it finds that agreements among PBO members would violate the competition law's prohibitions.

**Stronger competition policy will improve competitiveness…**

*"Healthy competition between companies trains an economy in adaptive capacities."*

A major impetus for reform of competition policy, as for structural reforms, is the need to improve dynamic competitiveness. An official explained the motivation for new legislation as "Healthy competition between companies trains an economy in adaptive capacities". Enterprises sheltered from competition lose that advantage, leaving them unable to respond to intensified competitive relationships, and to opportunities in the wider market.

The Netherlands' principal explicit reason for strengthening competition policy is to respond to the increasing interconnection of national economies by harmonising with European law and competition rules applicable under the Treaty of Rome. This desire is motivated in turn by recognition that national prosperity requires the capacity to respond to international developments.

**… while reflecting consumers' interests in free, fair market competition.**

*Competition and consumer policies are mutually supportive.*

Competition in the Netherlands has been vigorous for products exposed to international trade, and firms engaged at that scale have become efficient and competitive. Yet for most Dutch consumer purchases, domestic, not international, competition determines prices and quality. The Dutch reform programme is based on consumer interests. Its treatment of competition and consumer policies as mutually supportive provides a strong, integrated conceptual base for reform. Competition policy aims at ensuring that companies do not restrict or distort competition and limit consumer choice, while consumer policy aims at ensuring that consumers, by free and informed choices, can spur companies to improve performance and respond to demand. The major Dutch consumer organisation, Consumentenbond, has supported the adoption of the new competition law and enforcement structure.

**The new law follows the EU "prohibition" model concerning agreements and abuse of dominance.**

*The new law's system of prohibitions, like that of the European Union, reverses the burden of proof.*

The old Dutch law depended on case-by-case application of a general balancing test to determine that conduct violated the legal standard, and it was difficult to establish general rules. The old law's fundamental criterion was simply the "general interest", so every case could become a debate about the relative importance of competition policy. The new law's system of prohibitions, like that of the EU, reverses the burden, so that the company must demonstrate that agreements or behaviour which correspond to the law's prohibitions nonetheless do not conflict with the applicable standard. The change signifies a determination to change a fundamental attitude about competition.

The new competition law parallels the competition rules of the Treaty of Rome, and EU decisions and jurisprudence are likely to be a principal source of substantive guidance in interpreting it. The general prohibition of anti-competitive agreements, whether

horizontal or vertical, is subject to conditions and procedures for exemptions and dispensations which also parallel the EU system. The grounds for exemption or dispensation are the same as under the Treaty. Under this system, formal criteria will usually determine legality, while case-by-case economic analysis will be applied in considering applications for dispensation.

***The government adopted consistent, stringent rules on vertical agreements to emphasise the magnitude of the shift in policy.***

The new law's relatively stringent treatment of vertical agreements, although consistent with EU law, is inconsistent with the trend in many OECD countries toward case-by-case, economically-based analysis for vertical restraints (except for minimum resale price maintenance), and away from detailed, standardised rules. Many Dutch businesses advocated continuing to treat vertical agreements under the "abuse" principle, so that anti-competitive effect would be demonstrated in each particular case. But the government resisted that approach, in part because it wanted to adopt

Box 3.2. **The EU competition law toolkit**

The Dutch law follows closely the basic elements of competition law that have developed under the Treaty of Rome:

- **Agreements:** Article 85 prohibits agreements between undertakings, decisions of associations of undertakings and concerted practices that have the effect or intent of preventing, restricting, or distorting competition. The term "agreement" is understood broadly, so that the prohibition extends to arrangements that fall short of formal contracts enforceable at civil law. Some prohibited agreements are identified explicitly: direct or indirect fixing of prices or trading conditions, limitation or control of production, markets, investment, or technical development; sharing of markets or suppliers, discrimination that places trading parties at a competitive disadvantage, and tying or imposing non-germane conditions under contracts. And decisions have further clarified the scope of Article 85's coverage. Joint purchasing has been permitted (in some market conditions) because of resulting efficiencies, but joint selling usually has been forbidden because it amounts to a cartel. All forms of agreements to divide markets and control prices, including profit pooling and mark-up agreements and private "fair trade practice" rules, are rejected. Exchange of price information is permitted only after time has passed, and only if the exchange does not permit identification of particular enterprises. Exclusionary devices like aggregate rebate cartels are disallowed, even if they make some allowance for dealings with third parties.
- **Exemptions:** An agreement that would otherwise be prohibited may nonetheless be permitted, if it improves production or distribution or promotes technical or economic progress and allows consumers a fair share of the benefit, imposes only such restrictions as are indispensable to attaining the beneficial objectives, and does not permit the elimination of competition for a substantial part of the products in question. Exemptions may be granted in response to particular case-by-case applications. In addition, there are generally applicable "block" exemptions, which specify conditions or criteria for permitted agreements, including clauses that either may or may not appear in agreements (the "white lists" and "black lists"). Any agreement that meets those conditions is exempt, without need for particular application. Some of the most important exemptions apply to types of vertical relationships, including exclusive distribution, exclusive purchasing, and franchising.
- **Abuse of dominance:** Article 86 prohibits the abuse of a dominant position, and lists some acts that would be considered abuse of dominance: imposing unfair purchase or selling prices or trading conditions (either directly or indirectly), limiting production, markets, or technological development in ways that harm consumers, discrimination that places trading parties at a competitive disadvantage, and imposing non-germane contract conditions. In the presence of dominance, many types of conduct that disadvantage other parties in the market might be considered abuse. Dominance is often presumed at market shares over 50 per cent, and may be found at lower levels depending on other factors. The prohibition can extend to abuse by several firms acting together, even if no single firm had such a high market share itself.

consistent, across-the-board rules and to emphasise the magnitude of the cultural shift in policy, and also because the abuse principle had appeared not to be effective (see Box 3.2).

**The Dutch enforcement agency can now examine Dutch mergers.**

*The Minister of Economic Affairs can permit a merger if there are significant public interests at stake, but has announced restraint to avoid politicising merger decisions.*

Merger policy also parallels EU standards and methods. The law has been unexpectedly timely: the number of filings and merger investigations has been about double what had been anticipated. In principle, NMa will decide about mergers on the strength of competition-based considerations, in accord with the EU Merger Regulation. In practice, EU decisions sometimes also consider efficiency gains, but the NMa will not. The only source of balancing the competition based considerations against policy values will be through the possibility of Ministerial decision. When the director-general of the NMa has refused a licence for the realisation of a merger, the Minister of Economic Affairs still can grant that licence, if, in his view, this is necessary for serious reasons in the general interest, which outweigh the expected restriction of competition. The Minister shall issue his decision in accordance with the views of the Cabinet. Public interest considerations could include the companies' (international) competitive position and anticipated cost savings. The Minister has often stated that this power will be used with restraint to avoid basing merger evaluations on political judgements.

**The new enforcement body faces challenges in defining its independence.**

As important as the change in substantive law is the creation of new enforcement institutions. NMa is an entity within, but separated from, the Ministry of Economic Affairs. Decisional authority rests in NMa's Director General. As a law enforcement agency, NMa does not deal with competition policy, regulatory issues, or relationships with other ministries. These remain the responsibility of the Ministry of Economic Affairs.

*The new body's independence is qualified, but it may soon become clearer.*

The new body's independence is qualified, but it may soon become clearer. The Minister lacks the legal power to take decisions, but the Minister has the power to issue instructions to the Director General to preserve the Minister's responsibility and accountability to Parliament. The Minister has stated that the power is to be exercised with "maximum restraint", so that ministerial oversight, though theoretically possible, is (virtually) never actually implemented. To maintain distance and encourage actual independence, the relationship between the Minister and NMa is to be transparent. Separation and publicity may prove an effective check; at least, it will expose Ministerial intervention to political and public oversight. The Minister has announced the intention to give NMa maximum independent status as soon as possible, meaning that the minister would lose the power to issue instructions in individual cases.

*The possibility of auxiliary private action could lead to more effective enforcement.*

Private actions under national law procedures will also be available now that the law is based on the principle of prohibition. The possibility of auxiliary private action could lead to more effective enforcement, by bringing additional resources to the task.

Box 3.3. **National enforcement for national problems**

An advantage of bringing Dutch law into line with EU law, besides simplicity and transparency for Dutch business, will be that consistency should encourage the EU to leave local competition issues to local resolution, as called for by the principle of subsidiarity. Merger enforcement illustrates this principle. One of NMa's first big cases was the proposed combination of the KBB and Vendex retail chains. Before the new Dutch law was adopted, the EU Commission would have reviewed and decided that case, as it had a previous major merger involving retailing in the Netherlands. This time, the Dutch enforcement agency took responsibility and decided not to challenge the transaction. Smaller retailers who objected to the merger have vowed to challenge the NMa's decision in court.*

* *Financial Times*, 5 Nov. 1998 (Netherlands Country Review, p. III).

**These new institutions face important tests of how "competition principles" will be applied in practice.**

The Dutch law permitted parties to apply for dispensation for agreements already in existence. NMa was flooded with dispensation requests – over a thousand – at the deadline, 1 April 1998. Many appear to pertain to agreements that would obviously not be prohibited. But some represent continuation of existing controversies under the new procedures. How the new agency applies the new law to these old problems will be a critical test of its seriousness and effectiveness.

In addition, two general exemptions from the competition law require a balance between competition policy and other policy concerns.

***Until 2003, the competition law can be over-ridden by other laws and administrative actions, opening potentially large loopholes.***

– A broad "regulatory authorisation" exemption means that competition prohibitions do not apply to agreements subject to approval by an administrative agency under other laws, that could be prohibited by another agency, or that arise under another law. Competition law thus stands at the end of the priority line, opening potentially large loopholes. The exemption is set to lapse in 2003, and in the meantime debate will continue about how to set policy priorities. Potentially conflicting regulations include minimum price setting for natural gas, mandatory co-operation for small utility companies, fixed landing fees and passenger transport rates, and mandatory agreements for regional broadcasts. The competition law will be more effective as a tool for reform when this exemption expires.

***Utilities and other public service activities are also partially exempt from competition law.***

– The Competition Act also applies to entities providing services of general economic interest, that is utilities and other public service undertakings. The prohibition against restrictive agreements does not apply, though, if applying that prohibition would prevent performance of their special tasks. Also, the director-general of the NMa may declare the prohibition against abuse of a dominant position by an entity inapplicable to a specifically defined

practice in as far as the application of that prohibition prevents performance of the special tasks of that entity. Much will depend on how broadly NMa interprets the concept of "preventing" the performance of their tasks. The intention to follow EU principles and interpretations suggest that this exemption will be applied narrowly.

**Some interests demonstrated their continuing power by obtaining special treatment under the new law.**

*Special exemptions in several areas raise the cost of enforcement, and will reduce the gains from reform.*

The reach of competition policy is also limited by special exemptions. The competition law includes an explicit "bagatelle" exemption for agreements among small groups whose total turnover does not exceed statutory thresholds.[51] The somewhat similar *de minimis* provision of EU competition policy is a statement of intent not binding on the courts. The exemption's stated purpose is to remove the threat of prohibition and legal nullity from agreements of minor significance. But whether their competitive impact is minor depends on the market setting, not just on the firms' size. The partial exemption raises the costs of enforcement against anti-competitive actions by smaller firms.

Several special sectoral rules and exemptions were maintained or established in the enactment of the new law. Exemptions for joint tendering in contracting and for certain shopping centre lease provisions deserve close scrutiny in light of competition problems the Netherlands has experienced in the construction and retail sectors. Exemptions for publishing are problematic. Exemptions will continue for resale price maintenance for newspapers (block exemptions), books and music (individual dispensations), though it is doubtful that no less anti-competitive way could be found to achieve the policy goal.

**The relationship between competition policy and new institutions in network industries is still developing.**

*Current policy aims to prevent fragmented oversight and inconsistent application of competition concepts and to restrain the introduction of sector-specific competition rules.*

A major issue in the move from regulation to competition is the relationship between sector-specific regulation and competition policy. The government has announced sound principles to guide this relationship, but has been less successful implementing the principles. A January 1998 government statement aims to prevent fragmented oversight and inconsistent application of competition concepts and calls for restraint in the introduction of sector-specific competition rules. If sector-specific rules are unavoidable, the government held that they should overlap as little as possible with the general competition regime, their relationship to general rules should be defined as accurately as possible, they should be reassessed periodically, and they should be applied in co-ordination with NMa. If NMa itself or a chamber within NMa is not directly responsible, then the sectoral supervisor must reach agreement with NMa on how the general competition terms in sector-specific rules should be interpreted in individual cases.

*If a sector-specific decision is taken on competition, an independent competition assessment should be done so that any deviation from competition principles is transparent.*

In practice, however, the frameworks in some areas, particularly telecommunications and electric power, do not implement these sound principles. It is unclear that the mechanisms for consultation with NMa will be effective in promoting consistent competition concepts. If it is deemed necessary for a sector-specific regulator to decide based on public interest grounds, an independent competition assessment should be done, so that any deviation from competition principles is transparent. The division of responsibility is to be reviewed in four years, but in the meantime the competition agency's participation in actions with significant competitive impacts may be peripheral.

**More aggressive advocacy by the NMa would help speed up regulatory reform processes.**

Chapter 2 describes the continuing process of regulatory reviews under the MDW program, and the delays that have slowed concrete results. Advocacy by the NMa would boost this process, while promoting the concepts and visibility of the new competition policy.

**Government commitment, the modern law, and the well-designed new enforcement agency with strong leadership are the strengths on which further reform can build.**

*Further benefits can be expected as the new competition law is applied, particularly to formerly sheltered sectors.*

The Netherlands' current competition laws and institutions are too new to permit an evaluation of their performance against the substantive and process goals of reform. Because they are untested, their real powers and intentions are unknown. Much will depend on the strength and success of the new competition enforcement agency. The direction of change, however, is clear, and necessary to support supply-side reforms to the many protectionist arrangements of the welfare state. Although the pace has been slow, though perhaps a better description might be "deliberate", tangible benefits of greater competition have begun to appear. Further benefits can be expected as the new competition law is increasingly applied, particularly to formerly sheltered sectors.

*Chapter 4*

# ENHANCING MARKET OPENNESS THROUGH REGULATORY REFORM

Market openness further increases the benefits of regulatory reform for consumers and national economic performance. Reducing regulatory barriers to trade and investment enables countries in a global economy to benefit more fully from comparative advantage and innovation. As traditional barriers to trade have been progressively dismantled, "behind the border" measures have become more relevant to effective market access, and national regulations are exposed to unprecedented international scrutiny by trade and investment partners. Regulatory quality is no longer (if ever it was) a purely "domestic" affair.

**Dutch dependence on export-led growth has improved attention to transparency and efficiency of regulations in traded sectors.**

***The Netherlands has one of the most open economies in the world, and its prosperity largely depends on international trade and investment.***

The Netherlands has long enjoyed its reputation as one of the most open economies in the world and its prosperity has largely been dependent on foreign trade and investment. The exceptional international orientation of the Dutch is demonstrated by a combination of high ratios of imports, exports and foreign investment (see Figures 4.1 and 4.2). The share of exports and imports of goods in terms of GDP is close to 50 per cent, well above those of other OECD countries and is matched only by Belgium and Ireland. Foreign investment also plays a key role in the Dutch economy. Among OECD countries, the Netherlands, in relation to GDP, invests the most abroad. It is among the largest recipients of foreign investment.

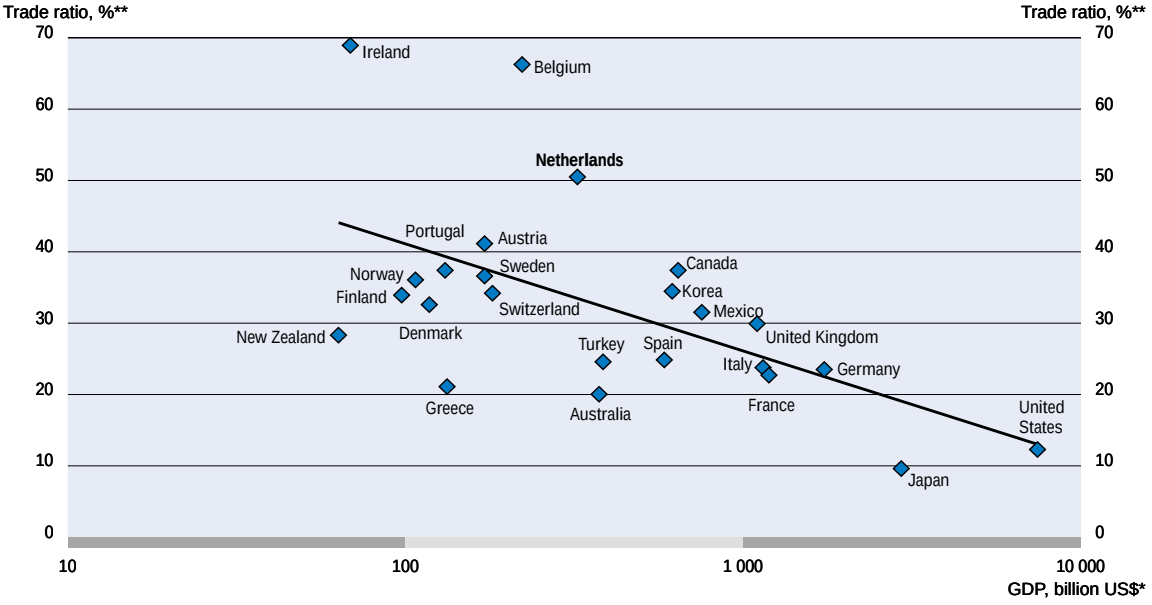
Its strategic location, its extensive sea and air transport infrastructure, and a stable and business-friendly environment have made it an attractive platform from which to serve the European market, and positioned it as an important transit country for European goods shipped outside Europe. Nearly half of all US companies and around 40 per cent of Japanese companies that established a European distribution centre have chosen the Netherlands.

***Therefore, the Netherlands has a major stake in ensuring that its domestic regulatory environment is open to foreign firms.***

The importance of foreign trade and investment for the prosperity of the country has generated a general policy stance of market openness among regulators and in the public administration, which have generated large benefits for the Netherlands. At least in traded sectors, the Netherlands has geared domestic and international policies to enhancing the attractiveness of its domestic

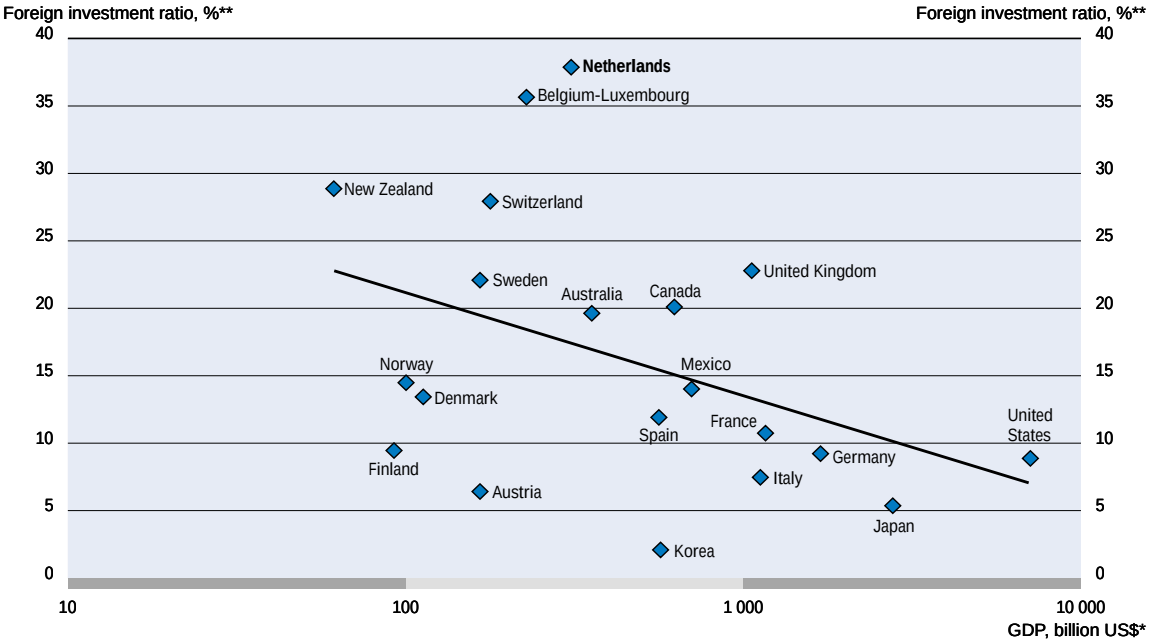
## Outward orientation of the Dutch economy

Figure 4.1. **Share of trade in selected OECD Member countries' economies, 1996**




* GDP measured at current prices and current PPPs in billion US dollars.
** Average of exports and imports of goods and services relative to GDP.
This ratio includes trade simply transiting through the Netherlands; however, this probably does not significantly distort the picture of market openness, since much of "transit" trade reflects the attractiveness of the Netherlands as a "gateway" to Europe.
*Source:* OECD.

Figure 4.2. **Share of stocks of inward and outward direct investment in GDP in 1995**




* GDP measured at current prices and current PPPs in billion US dollars.
** Average of inward investment and outward investment relative to GDP (except for Mexico, inward only).
*Source :* OECD, AFA databases (DSTI, EAS Division) and DAFFE's Foreign Investment Database.

market for foreign businesses, and the international competitiveness of Dutch firms. As a result, the Netherlands has rarely been at the centre of trade or investment disputes.[52] Foreign trading partners surveys consistently express a high degree of satisfaction with the Dutch regulatory environment.[53]

**The Dutch experience also demonstrates that regulatory and competition reforms support market openness.**

*Good regulation in domestic markets is good regulation for foreigners.*

Dutch experience supports the proposition that good regulation in domestic markets is good regulation for foreigners. Dismantling of economic regulation has yielded opportunities for foreign traders and investors. Expansion of store opening hours and the flexibility of fixed term contracts have aided foreign suppliers in competing in Dutch markets. Cost-efficient regulation and greater analytical rigour in assessing the impacts of proposed regulations support legitimate domestic policies, but can also be market-opening. Likewise, the new competition policy, while targeted at domestic competition, will also help produce regulation that is trade and investment neutral.

*The virtuous cycle between efficient regulation and market openness is particularly evident in Europe, where EU members have an interest in the efficiency of each other's regulation.*

The virtuous cycle and shared interests between efficient regulation and market openness is particularly evident in Europe. In the Netherlands, as in other EU members, much domestic regulation is shaped by the regulatory process at the European level and thus indirectly influenced by the policies and regulatory culture of the other members. Liberalisation of Dutch markets has been enhanced by European integration, while implementation of the single market has improved the conditions under which other countries can access Dutch markets (Hoeller *et al.*, 1998). At the same time, the momentum of the European integration owes much to the Dutch tradition of market openness, which has been one of the driving forces behind the liberalisation of European markets.

*But transition to open markets in historically non-traded sectors may not be rapid or easy.*

Non-traded areas of the Dutch economy are so far untested in international competition. These include construction, utilities, certain financial transactions, and consumer services. In increasingly globalised markets, these sectors will face international competition. Regulators in these sectors must, as a consequence, demonstrate that they live up to the market openness tradition in the historically traded sectors. Given corporatist traditions in these sectors, and their reluctance to fully apply the new competition law, the transition to an open market may not be rapid or easy.

**The Netherlands shows good performance with respect to the OECD efficient regulation principles.**

The efficient regulation principles are presented in Box 4.1. Although in many cases the "efficient regulation" principles have not been translated into formal requirements in the Netherlands when developing domestic regulations, the principles seem to be well observed in practice within the domestic regulatory process. It can be argued that trading traditions and awareness of the importance of

foreign trade and investment for the prosperity of the country are so well anchored in the habits of the public sector that institutional safeguards are superfluous.

***Market openness can be enhanced by improving transparency in self-regulation, and implementing competition policy in cartelized sectors.***

Yet Dutch market openness could be further enhanced by improving the transparency of self-regulatory schemes (see also Chapter 2) and by effectively implementing the new competition policy regime in sectors characterised by cartel arrangements.

**Measures to avoid unnecessary trade restrictiveness are relatively strong in the Netherlands due in part to EU checks and scrutiny.**

To avoid unnecessary trade restrictiveness, regulators should assess the impact of new regulations on international trade and investment; consult trade policy bodies, foreign traders and investors in the regulatory process; and ensure access by foreign parties to dispute settlement.

Box 4.1. **The OECD efficient regulation principles for market openness**

To ensure that regulations do not unnecessarily reduce market openness, "efficient regulation" principles should be built into domestic regulatory processes for social and economic regulations, and for administrative formalities. These principles, described in *The OECD Report on Regulatory Reform* and developed in the OECD's Trade Committee, have been identified by trade policy makers as key to market-oriented, trade and investment-friendly regulation. This review does not judge the extent to which the Netherlands has complied with international commitments, but assesses whether and how domestic regulations and procedures are consistent with these substantive principles.

- ***Transparency and openness of decision making.*** Foreign firms, individuals, and investors seeking access to a market must have adequate information on new or revised regulations so they can base decisions on accurate assessments of potential costs, risks, and market opportunities.
- ***Non-discrimination.*** Non-discrimination means equality of competitive opportunities between like products and services irrespective of country of origin.
- ***Avoidance of unnecessary trade restrictiveness.*** Governments should use regulations that are not more trade restrictive than necessary to fulfil legitimate objectives. Performance-based rather than design standards should be used as the basis of technical regulation; taxes or tradable permits should be used in lieu of regulations.
- ***Use of internationally harmonised measures.*** Compliance with different standards and regulations for like products can burden firms engaged in international trade with significant costs. When appropriate and feasible, internationally harmonised measures should be used as the basis of domestic regulations.
- ***Recognition of equivalence of other countries' regulatory measures.*** When internationally harmonised measures are not possible, necessary or desirable, the negative trade effects of cross-country disparities in regulation and duplicative conformity assessment systems can be reduced by recognising the equivalence of trading partners' regulatory measures or the results of conformity assessment performed in other countries.
- ***Application of competition principles.*** Market access can be reduced by regulatory action condoning anticompetitive conduct or by failure to correct anticompetitive private actions. Competition institutions should enable domestic and foreign firms affected by anti-competitive practices to present their positions.

*There is an explicit requirement to assess trade impacts for regulations…*

In the Netherlands, these tasks have been folded into the general programme for regulatory impact analysis and interministerial co-ordination. There is an explicit requirement to assess trade impacts, and trade policy makers may suggest, but not request, modification or withdrawal of domestic regulations of other ministries on the grounds of unnecessary trade restrictiveness.

*… and tougher EU controls reinforce domestic efforts to avoid unnecessary trade restrictiveness.*

EU membership has added another level of quality control that is useful in reinforcing these efforts. Effects of proposed regulations on trade and investment are assessed by the Ministry of Justice, which checks the quality of legislation including compliance with WTO and EU rules. Participation of the Netherlands in the single market entails a clear commitment *vis-à-vis* other EU members to avoid unnecessary trade restrictiveness of domestic regulations with respect to the areas covered by the single market. Further, under Directive 83/189/EEC, recently consolidated as Directive 98/34/EEC, technical regulations drafted at the domestic level are subject to the scrutiny of the Commission and other Member States to prevent the creation of new technical barriers to intra-Community trade.

**The Netherlands has a strong record of use of European and internationally harmonised measures.**

*Dutch policy encourages the use of internationally harmonised measures, going beyond European requirements.*

The single market has reinforced the Dutch policy of encouraging the use of internationally harmonised measures. Differences in technical standards and regulations among countries can distort trade by introducing non-tariff barriers for products and services. Reducing such barriers by international harmonisation of standards and regulations is a goal of the WTO Agreement on Technical Barriers to Trade and a pillar of the European single market.

*The government also promotes standardisation, testing and certification by market players as an alternative to government regulation.*

Dutch policy on technical regulations aims to limit government intervention to the setting of essential requirements and leaving technical details to standardisation, testing and certification by industry. Under its single market obligations, the Dutch government promotes standardisation, testing and certification by market players as an alternative to government regulation. The Netherlands Standardisation Institute (NNI), which is the national central standardisation body, implements European and international standards and withdraws national standards if international standards are available.

NNI's standardisation activities are geared towards the adoption of international standards, resulting in easier access by foreign products to the domestic market, and an additional competitive edge in global markets for Dutch producers. By July 1996, the NNI had published over 9 000 finalised technical standards, a fifth of which were purely national standards, but of the 3 500 draft standards in preparation at that time, only 6 per cent were purely national. The number of purely Dutch standards is declining as the scope for European harmonisation has increased and limited the need for national standards.

The Netherlands, under European New Approach directives, has adopted legislation on certification procedures, implementing the "modules" laid down by the Global Approach for affixing the

CE-marking (see Box 4.2). For non-European countries, there are currently efforts at the European level to recognise the equivalence of regulation and results of conformity assessment performed in third countries, although their implementation partly depends on national authorities and institutions. EU recognition of the equivalence of third country regulations and the results of conformity assessments, is through Mutual Recognition Agreements (MRAs). The European Commission has negotiated such agreements with the United States, Canada, New Zealand and Australia. It will be interesting to see how successful these agreements will be in reducing technical barriers related to regulatory divergence, and whether their benefits will be sufficient to justify the difficulty of their negotiation.

### Box 4.2. Standards harmonisation in the European Union[1]

**The New Approach and the Global Approach**

The need to harmonise technical regulations when diverging rules from Member States impair the operation of the common market was recognised by the Treaty of Rome in Articles 100 to 102 on the approximation of laws. By 1985 it had become clear that relying only on the traditional harmonisation approach would not allow the achievement of the Single Market. As a matter of fact, this approach was encumbered by very detailed specifications which were difficult and time consuming to adopt at the political level, burdensome to control at the implementation level and requiring frequent updates to adapt to technical progress. The adoption of a new policy towards technical harmonisation and standardisation was thus necessary to actually ensure the free movement of goods instituted by the Single Market. The way to achieve this was opened by the European Court of Justice, which in its celebrated ruling on *Cassis de Dijon*[2] interpreted Article 30 of the EC Treaty as requiring that goods lawfully marketed in one Member State be accepted in other Member States, unless their national rules required a higher level of protection on one or more of a short list of overriding objectives. This opened the door to a policy based on mutual recognition of required levels of protection and to harmonisation focusing only on those levels, not the technical solution for meeting the level of protection.

In 1985 the Council adopted the "**New Approach**", according to which harmonisation would no longer result in detailed technical rules, but would be limited to defining the essential health, safety and other[3] requirements which industrial products must meet before they can be marketed. This "New Approach" to harmonisation was supplemented in 1989 by the "**Global Approach**" which established conformity assessment procedures, criteria relating to the independence and quality of certification bodies, mutual recognition and accreditation. Since the New Approach calls for essential requirements to be harmonised and made mandatory by directives, this approach is appropriate only where it is genuinely possible to distinguish between essential requirements and technical specifications; where a wide range of products is sufficiently homogenous or a horizontal risk identifiable to allow common essential requirements; and where the product area or risk concerned is suitable for standardisation. Furthermore, the New Approach has not been applied to sectors where Community legislation was well advanced prior to 1985.

On the basis of the New Approach manufacturers are only bound by essential requirements, which are written for generic categories of products and do not require a unique technical solution. Manufacturers are free to use any technical specification appropriate to meet these requirements. Products that conform are allowed free circulation in the European market.

For the New Approach, detailed harmonised standards are not indispensable. However, they do offer a privileged route for demonstrating compliance with the essential requirements. Elaboration at European level of technical specifications meeting those requirements is no longer the responsibility of government bodies but has been entrusted to three European standardisation bodies mandated by the Commission. The CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standards) and ETSI (European Telecommunications Standards Institute) are all signatories to the WTO TBT Code of Good Practice. When harmonised standards produced by the CEN, CENELEC or ETSI are

Box 4.2. **Standards harmonisation in the European Union**[1] *(cont.)*

identified by the Commission as corresponding to a specific set of essential requirements, the references are published in the Official Journal and they become effective as soon as one Member State has transposed them at the national level and retracted any conflicting national standards. These standards are not mandatory. However conformity with them confers a presumption of conformity with the essential requirements set by the New Approach Directives in all Member States.

The manufacturer can choose to demonstrate conformity with the essential requirements by other means. This is clearly necessary where harmonised European standards are not (or not yet) available. Each New Approach directive specifies the conformity assessment procedures to be used. These are chosen among the list of equivalent procedures established by the Global Approach (the so-called "modules"), and respond to different needs in specific situations. They range from the supplier's declaration of conformity, through third party type examination, to full product quality assurance. National public authorities are responsible for identifying and notifying competent bodies, entitled to perform the conformity assessment, but do not themselves intervene in the conformity assessment. When third party intervention is required, suppliers may address any of the notified bodies within the European Union. Products which have successfully undergone the appropriate assessment procedures are then affixed with the CE marking, which grants free circulation in all Members, but also implies that the producer accepts full liability for the product.[4]

The strength of the New Approach and the Global Approach lies in limiting legal requirements to what is essential and leaving to the producer the choice of the technical solution to meet this requirement. At the same time, by introducing EU-wide competition between notified bodies and by building confidence in their competence through accreditation, conformity assessment is distanced from national control. The standards system, rather than being a means of imposing government-decided requirements, is put at the service of industry to offer viable solutions to the need to meet essential requirements, which however are not in principle binding. The success of the New and Global Approaches in creating a more flexible and efficient harmonised standardisation process in the European Union heavily depends on the reliability of the European standardisation and certification bodies and on the actual efficiency of control by Member States. First, European standardisation and certification bodies need to have a high degree of technical competence, impartiality and independence from vested interests, as well as to be able to elaborate the standards necessary for giving concrete expression to the essential requirements in an expeditious manner. Second, each Member State has the responsibility to ensure that the CE marking is respected and that only products conforming with the essential requirements are sold on its market. If tests carried out by a notified body are cast in doubt, this should be followed up by the supervisory authorities of the Member State concerned.

1. See Dennis Swann (1995), *The Economics of the Common Market*, Penguin Books; European Commission, "Documents on the New Approach and the Global Approach", III/2113/96-EN; European Commission, DGIII Industry, Regulating Products. Practical experience with measures to eliminate barriers in the Single Market; ETSI, *European standards, a win-win situation*; European Commission (1994), *Guide to the implementation of Community harmonisation directives based on the new approach and the global approach* (first version), Luxembourg.
2. Decision of 20 February 1979, Cassis de Dijon, Case 120/78, ECR, p. 649.
3. Energy-efficiency, labelling, environment, noise.
4. Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the liability for defective products.

### Vigorous application of competition principles holds the largest potential for further improvement in market openness…

***Market openness has been reduced in the past by corporatist traditions that disadvantage foreign entrants.***

Strong corporatist traditions and the lack of enforcement of competition principles, which earned the Netherlands its reputation as a "cartel paradise", appear to have complicated access to the Dutch market for foreign new entrants.[54] The new competition law (see Chapter 3) could remedy this situation. Ensuring that the new law and supporting policies are effective in suppressing private anti-competitive behaviour affecting foreign entry to markets will be

the main challenge with respect to market openness in the Netherlands in the short to medium term.

**… and without formalised rules and procedures, Dutch self-regulatory arrangements can exclude foreign interests.**

Possible *de facto* exclusion of foreign interests are particularly a concern for self-regulatory activities undertaken by "statutory industrial organisation bodies" (PBOs) (see Chapter 3) and organisations such as the Consumentenbond (the Netherlands consumers association). Self-regulatory activities naturally represent the interests of the industries represented in the PBOs. As economies have globalised, the structure of these bodies may no longer provide sufficient room for taking into account third party concerns. This may undermine the general market openness orientation of the regulatory environment in the Netherlands.

***Current controls over self-regulatory activities do not seem sufficient to ensure that PBOs subscribe to market openness principles.***

PBOs are not allowed to impede fair competition, but this provision does not necessarily prevent PBOs from producing regulations that do not take adequate account of foreign concerns or that unnecessarily restrict trade. Current controls over self-regulatory activities do not seem sufficient to ensure that PBOs subscribe to market openness principles. It would be useful for the government to regularly assess the effects of self-regulatory activities on competitiveness and market openness.

*Chapter 5*

# REGULATORY REFORM IN THE ELECTRICITY INDUSTRY

Current Dutch efforts to liberalise the power sector while diversifying fuel sources and introducing stringent environmental policies place the Netherlands in the forefront of OECD countries in tackling the complex reform issues in this sector. The regulatory challenges are formidable: the regulatory framework must provide for the development of a competitive market, but must also find efficient ways to meet environmental, safety, social and consumer protection objectives. The framework must support long term security and reliability of supply for electricity and deal with converging interests between electricity and gas regulation, and electricity and competition regulation.

***Dutch reforms hold good prospects for future economic and environmental performance, but faster and deeper reforms would boost gains.***

The Dutch response, going beyond European directives, holds good prospects for future economic and environmental performance. Benefits could be reduced, however, by delays in introducing competition, by incremental and incomplete changes in some areas, and by the potential for confusion among the new institutions. Faster and deeper reforms would boost gains for consumers and user industries.

**Reform in the power sector will boost performance and reduce costs for consumers and downstream sectors.**

***Price declines of 11 per cent are possible, which would stimulate an 11 per cent increase in output.***

Although the electricity sector accounts for less than one per cent of employment and two per cent of Dutch GDP, the sector is strategically important as a key input to other sectors of the Dutch economy. Liberalising the electricity market could improve capital and labour productivity, reducing electricity prices and boosting output. Estimates are summarised in Box 5.1.

***Poor regulatory incentives and non-competitive structures have undermined sectoral performance.***

These large gains are possible because poor regulatory incentives and competition-dampening structures undermined sectoral performance. The sector is highly concentrated (see Table 5.1). Four regional generation and transmission public companies, producing 61 per cent of Dutch power, are owned by municipalities and regional authorities. The four co-ordinate activities through SEP,[55] a public limited company jointly owned by the four producers. SEP is also the system operator, dispatching power and selling electricity to suppliers at an average cost price, and owns the national grid.

Box 5.1. **Potential benefits of electricity market liberalisation in the Netherlands**

A study commissioned by the OECD (OECD, 1997) noted that labour productivity in the Netherlands was low, lagging well behind the US. Significant surplus capacity (although common among utilities) also implied that capital productivity was suboptimal. The study cites other work that suggests public utility worker pay was higher than workers in comparable industries.

The analysis develops a base scenario on the impact of market liberalisation: a 50% improvement in labour productivity, a 5% reduction in wages and profits, and a 25% cut in capital costs and a 5% boost in output from increased innovation. The analysis predicts an 11% reduction in prices and a 5.7% boost in output. Given the total turnover for the sector of about 12 billion DFl, an 11% price reduction represents reduction in costs for consumers of 1.3 billion guilders per annum. There is, however, a 25% employment loss in the sector from the efficiency improvements.

As reported in Chapter 1, Haffner and van Bergeijk (1997) estimated that far-reaching reforms would reduce prices by 11 per cent, boost output by 11 per cent, and result in more innovation and customer service.

Around 20 companies owned by municipal and provincial authorities distribute and supply 7 million consumers.

**The sector suffers from weak efficiency incentives, distorted entry into generation, and burdensome regulation.**

Although 1989 reforms took steps toward competition by partly restructuring the sector, it was clear that the sector badly needed further reform. Effective competition did not emerge because generation and supply (potentially competitive) were still tied with transportation (a natural monopoly), distorted incentives produced excess capacity, and regulatory oversight was highly interventionist. The results were:

*Higher costs were simply passed on to consumers through higher prices.*

– **Weak productive efficiency incentives:** Cost efficiency incentives are weak. The four incumbents have little incentive for cost efficiency as they are able to pass through costs in prices. Growth in CHP production ate away at the producers' market share, resulting in under-utilised capacity and higher unit production costs. These costs were passed to customers as higher prices.

*A vicious circle of inefficiency was created by perverse incentives.*

– **Distorted generation entry:** Too much CHP investment forced SEP to limit output from plants which were economic on a short-term marginal cost basis. Prices, which would fall in a market to adjust for over-capacity, instead rose to recover higher unit costs for SEP. Higher SEP prices in turn encouraged distributors to develop more CHP, leading to less SEP output and a vicious circle of inefficiency.

*Laborious regulation and approvals inhibited flexibility and responsiveness.*

– **Unwieldy central generation approvals process:** Planning and approving generation required parliamentary and often judicial assent. This laborious process was inconsistent with a favourable approvals process for CHP, and inconsistent with

dynamic decision making needed for production companies to compete in opening European markets.

**Reform was launched in 1998 with wholescale structural, regulatory, and institutional changes.**

***The 1998 reforms introduced competition and strengthened environmental goals, but also set into motion a risky transition policy to reduce shocks to Dutch generators.***

Aided by the European liberalisation that led to the 1996 Directive, three major themes guided the Dutch reforms: *1)* greater competition in the electricity sector is inevitable and desirable, a policy consistent with the International Energy Agency's Shared Goals; *2)* sustainability and fuel diversification are important (goals were set to improve energy efficiency by one third and increase renewable energy supply from 1 per cent to 10 per cent by 2020); and *3)* managing the transition to ensure a robust Dutch electricity industry is necessary (Dutch reformers highlighted the weak financial position of Dutch generators, and warned that large foreign utilities could seize the Dutch market).

The key reform instrument was the 1998 Electricity Act. Its main features are summarised in Table 5.1.

**These reforms will liberalise consumer choice in stages between 1999 and 2007, but the delays will postpone benefits.**

The Dutch scheme will open to competition increasing shares of electricity markets, based on size of user. Large customers will be able to contract freely in 1999, medium in 2002, and small in 2007 (see Table 5.1). This scheme is based on, but opens competition faster than, the EU directive on the internal market for electricity (EC 96/92). Yet even this schedule is very lengthy, and the limitations on aggregation of purchases are unnecessary barriers to the introduction of vigorous competition. Customer choice, which is fundamental to an effective market, is being introduced too slowly. The timetable should be advanced, and small customers should be able to take advantage of competition earlier through aggregation.

**Energy efficiency and environmental goals for carbon dioxide emissions are pursued through multiple policy instruments, including both direct interventions and market incentives…**

The commitment to limit national emissions of carbon dioxide to 1990 levels by the year 2000 is being implemented by programmes and economic instruments of varying cost-effectiveness. The Netherlands Kyoto target (a 6 per cent reduction of greenhouse gas emissions from 1990 levels over the period 2008-2012) will be difficult to achieve, and policies should be as cost-effective as possible.

***Promotion of CHP generation has led to considerable over-capacity, raising doubts about its value as an environmental strategy.***

Promotion through a series of highly interventionist tools of Combined Heat and Power (CHP) electricity generation to compete with existing utility generation is the most significant. CHP now produces 26 per cent of electricity for the Dutch market, one of the largest shares in the OECD. The efficiency of this strategy is questionable. Although carbon dioxide emissions intensity has fallen to 0.5 kg/kWh, due in part

Table 5.1. **Comparison of the Dutch industry structure and regulation: impact of 1998 Electricity Act**

| Area | Old | New |
|---|---|---|
| **Generation** | *a)* Four generation/transmission (production) companies co-ordinated through SEP. CHP development by industries/distributors.<br>*b)* Parliamentary approval for new central generation. Few barriers for decentralised generation.<br>*c)* Central generation operation and planning of four production companies co-ordinated by SEP. Imports by SEP. | *a)* Four production companies to be separated. Numerous CHP plants in place as a result of 1989 Act.<br>*b)* Free entry for all domestic production to contract with distributors and eligible customers.<br>*c)* Reciprocity requirements on imports. |
| **Transmission** | *a)* Transmission owned by the four production companies through ownership of SEP, who acts as system operator.<br>*b)* Transmission expansion requires Parliamentary/ judicial approval.<br>*c)* Postage stamp pricing for transmission.<br>*d)* Ancillary services pricing for decentralised generation. | *a)* Transmission assets of SEP jointly operated by independent network manager. Dutch government to hold 50% plus 1 of the shares. Oversight by independent governing board.<br>*b)* Non-discriminatory terms of access to the grid (transmission and distribution tariffs) regulated by network regulator and also approved by competition authority.<br>*c)* Postage stamp pricing.<br>*d)* Non-discriminatory ancillary services proposed.<br>*e)* Transmission investment plans reviewed by network regulator. |
| **Distribution** | *a)* Distribution and supply bundled in 23 municipal/provincial public limited companies operating under monopoly concession.<br>*b)* Significant investment by distributors in CHP generation.<br>*c)* Number of distributors decreasing through mergers.<br>*d)* Distributors able to contract with generators other than the four production companies, but so far little incentive to do so. | *a)* Distribution services under independent distribution services operator. Oversight by independent board.<br>*b)* Merger activity continuing.<br>*c)* Non-discriminatory terms of access to the grid (transmission and distribution tariffs) regulated by network regulator and also approved by competition authority.<br>*d)* Distribution and supply operationally separated with independent boards.<br>*e)* Distributors able to contract with other generators. |
| **Supply and end user choice** | *a)* Distributors are also suppliers. No independent suppliers. Large customers able to import but few have done so.<br>*b)* Maximum customer tariffs approved by ministry. | *a)* Customers able to contract freely according to size – large customers in 1999, medium 2002, small 2007.<br>*b)* Distributors licensed to act as exclusive, regulated suppliers for captive customers.<br>*c)* Prices for free customers unregulated.<br>*d)* Prices for captive customers regulated by Minister under license. |
| **Regulator** | Regulation carried out by Ministry of Economic Affairs. | *a)* New sector regulator (DTE) and competition authority (NMa). (DTE is a chamber of NMa.)<br>*b)* Minister retains some regulatory responsibilities, notably setting tariffs for captive customers, imports, privatisation. |
| **International trade** | Central producers have monopoly through SEP. Very large customers (not distributors) can arrange imports. | Central producers able to continue existing import contracts. Customers/licensed suppliers able to purchase imports if reciprocal access available. |
| **Environment** | Energy Efficiency programmes by distributors recovered through rates subsidies/green pricing of renewables. | *a)* Continuation of existing programmes.<br>*b)* New “green certificates” obligation on consumers to acquire renewable energy implemented through market mechanism. |
| **Taxes and subsidies** | Utilities tax exempt, as publicly owned. CHP entry subsidised. | Tax exemption and explicit CHP subsidies removed. |
| **Ownership** | Municipal/provincial authorities own all central (and some CHP) generation, all transmission and distribution. Cross ownership links between production companies and distributors. | Unchanged. Law requires ministerial approval for privatisation prior to 2002. |

to a doubling of CHP capacity, there is substantial over-capacity in Dutch generation because of continuing investment in CHP.

Electricity production and distribution sectors were encouraged to enter into covenants (see Chapter 2) with the government on energy efficiency. Direct costs of the environmental programs of the distribution utilities are estimated to raise the domestic electricity bill by 0.8% (PiE, 1998*d*), while reducing national emissions by 17 million tonnes of $CO_2$ by the year 2000 (equivalent to about 10 per cent of Dutch national emissions).

***Taxes and voluntary charges are also being used.***

In addition to subsidies and voluntary agreements, the government introduced the Regulatory Energy Tax (REB) (MEZ, 1997), which raised electricity prices to households and small consumers by 15 per cent. Renewable energy is exempt from the tax. The tax is applied to only a small amount of energy used, hence the impact of the tax on large users is small (0.8%).[56] Utilities also offer "green pricing" for renewable electricity to customers at a premium of about 15 per cent above the cost of regular supplies (PiE, 1997*c*). These premiums do not, in general, recover the entire additional cost of renewables, and the remainder is recovered from all customers through rates.

**… of which the most promising is a scheme for marketable certificates in green energy.**

***Green certificates for renewables is a transparent market mechanism for the development of renewable resources.***

The green certificates program for renewables is a laudable attempt to find a transparent market-based mechanism for the development of renewable resources. This approach promises to be a highly cost-effective means of reaching the target of 10 per cent of primary energy supply from renewable resources by 2020 (MEZ, 1997).

Renewable energy producers are issued certificates corresponding to their total contribution of renewable electricity to the Dutch market. The Minister creates a demand for these certificates by requiring all consumers to have a specified portion of certificates for their use (perhaps 5 per cent of all electricity purchased). Electricity users (or their suppliers) buy the certificates from producers directly or purchase them through a market (much as tradable emissions permits are traded). The trading price for the certificates should represent the marginal premium for renewable energy – providing transparent price signals and developed markets for potential entrants in the renewable energy market, and putting cost pressures on renewables producers.

***Vigilance about the design and function of the certificates market will be needed to preserve its efficiency and credibility.***

Vigilance about the design and function of the new market will be needed. Green certificate prices could be volatile, particularly if the Minister's target is set too high.[57] Verification of green production, particularly for foreign producers, is potentially costly, yet essential for the credibility of the programme. Renewable energy costs can be significantly affected by the electricity market rules. Dutch designers have tried to ensure that market access rules, such as the pricing of ancillary services for intermittent sources of supply such as wind and solar energy, avoid unnecessary barriers or

unjustified costs for smaller sources. Emissions regulation and policy will continue to be developed by the Ministry of Housing, Spatial Planning, and the Environment, and hence close co-ordination between this Ministry and the Ministry of Economic Affairs will be essential to policy coherence.

**Rapid decisions on stranded cost recovery are necessary to speed up market development.**

*A plan to deal efficiently with stranded costs is critical, since production companies are already in a weak financial position that will worsen.*

Effective handling of transition issues – in particular costs stranded from an earlier regulatory regime – is fundamental to the success of market reform by ensuring a level playing field for new entrants and support for reform by incumbents. In the Netherlands, stranding of costs arises from downward pressure on prices and the uncompetitiveness of past "public policy" investments and long-term contracts on CHP investments. The government's concern over the financial health of the four existing production companies is consistent with an extensive programme for stranded cost recovery, but there are insufficient provisions for this in the current law. A plan to deal efficiently with stranded costs is critical at this stage.

Fortunately, the Netherlands government recently reached an agreement with the companies on stranded costs. The agreement clarifies precisely what stranded costs will be recoverable and how they will be recovered from customers. This agreement, which will require approval of the Dutch parliament, is a very positive development for Dutch reform. By acquiring a 50 per cent share of the high voltage system, the government enhances separation between generation and transmission, decreasing the likelihood of discrimination. It sets a high standard of what costs will be recoverable and thus will encourage financial restructuring (and possibly privatisation) of the production companies. Rapid acceptance of this agreement will set reform on a sounder basis.

**Limited separation of distribution from generation and supply will require heavy and possibly ineffective regulatory oversight.**

*The new law aims to ensure non-discriminatory access to transmission and distribution grids through regulated third party access.*

An aim of the new law is to ensure non-discriminatory access to transmission and distribution grids through regulated third party access, the most liberal of the access procedures in the EU Directive. Generation and transmission activities of the production companies are to be operationally separated, and put under control of an independent governing board. Separation of the distribution network from the supply business of the distributors with an independent governing board is also mandated. Further, independent network managers are required for the national high voltage transmission network and each distribution network.

*The degree of separation proposed in the Netherlands may not be sufficient to ensure non-discriminatory access to networks, particularly local distribution.*

This degree of separation is consistent with the EU directive, but the decision of the Dutch government not to require full structural separation of generation from transmission (*i.e.*, for generation and transmission to be in separate companies) is at odds with other OECD countries. Many OECD countries that have opted to

Table 5.2. **Status of transmission business in OECD jurisdictions with reformed electricity sectors**

| Separate transmission company required | Separate transmission company not required |
|---|---|
| Australia (most states), Finland, Hungary, New Zealand, Norway, Spain, Sweden, United Kingdom (England and Wales only) | Germany, Italy, United States |

*Source:* Responses to OECD/IEA 1998 Electricity Indicators Questionnaire.

introduce competition in generation have also opted for a separate transmission company to operate the grid system (see Table 5.2) to ensure non-discrimination. The recent agreement between the government and the utilities to give the national government 50 per cent plus one shares in the national high voltage grid in return for recovery stranded costs diminishes this concern, but it is not clear that the level of separation proposed in the Netherlands will be sufficient to ensure non-discriminatory access to networks, particularly local distribution. A heavy burden will be placed on the new regulator to ensure that there is no cross subsidy between regulated and competitive businesses.

There is also the issue of ownership of the national grid. Majority state ownership of the grid diminishes concerns about discrimination. Early privatisation of the grid would alleviate such concerns.

**New regulatory institutions will support the emergence of effective competition, though weaknesses need further attention.**

***Three entities will share regulatory oversight of the new electricity markets.***

Effective regulation through robust regulatory institutions is essential to ensure the development of competitive and efficient markets. Electricity regulation under the new system will be carried out by three entities, a new network regulator (DTE), the new competition authority (NMa), and the Minister directly. In the near future, the network regulator will be fully part of the competition authority. Instead of three regulating entities, there will be two regulating entities.

– *Network regulator (DTE)*: DTE, a chamber of the Dutch competition agency, will regulate transmission and distribution grids, including grid access prices and other terms of access, and will review plans for network expansion. Network tariffs are to be set according to a multi-year price cap (similar to the United Kingdom). Early challenges for DTE include cost allocation to avoid cross subsidy between (monopoly) grid activities and generation and supply; transmission pricing and availability, particularly interconnections for imported electricity; pricing of ancillary services, particularly for CHP and for renewables, to ensure efficient entry.

– *Competition authority (NMa)*: The NMa has general responsibilities to police mergers, horizontal and vertical agreements in the new electricity markets. This will be critical after reform due to possible mergers in generation, existing horizontal arrangements between production companies, and vertical

arrangements between the production companies and the distributors. NMa also has specific responsibilities to reach agreement with DTE on grid tariffs and access rules, and to resolve disputes over grid access terms.

– *Minister of Economic Affairs*: The Minister will play a significant role in regulating the sector by regulating prices for customers with no choice of supplier, and setting terms and conditions of supply to these customers through licensing. Prices for supply are to be set through a multi-year price cap formula; setting the right "X" factor in the price cap will be a challenge. The Minister can grant dispensations on a number of issues, most importantly on permitting imports from a country where a customer is not able to choose a supplier (reciprocity). Ministerial approval is required for privatisation of production and network assets through 2002, with the possibility of extending this requirement for networks for four years.

***The role of the Minister as regulator is too extensive, given conflicting objectives in the Ministry. Establishment of a fully independent regulator should be considered.***

These institutional arrangements are mostly sound, but a major concern is that the role of the Minister as regulator is too extensive, given conflicting objectives in the ministry. For example, given the government's concern over the finances of the incumbent companies, the Minister could restrict imports (by use of the reciprocity article), and allow above market production costs to be passed through to customers to protect incumbents. In the short-term, delegation of more duties to the new regulator and competition authority would improve market transparency and confidence. Once stranded cost recovery rules are in place, establishment of a fully independent regulator should be considered, while maintaining ministerial accountability for overall policy and results. In any event, careful co-ordination is planned (and needed) between DTE and NMa.

**Finally, misguided attempts to shelter incumbents from the market will impose high costs on consumers.**

***Measures to soften the transition for incumbents can hamper competition and reduce entry.***

The goal of ensuring a robust Dutch electricity industry was, in practice, too often been viewed as protecting the four incumbent companies during the transition. This can have perverse effects. Development of a competitive generation sector can be promoted by removing barriers to entry, but protecting existing incumbents softens the impact of reform. Measures to soften the transition for incumbents can hamper competition and create uncertainty that reduces entry.

Concern over the incumbents has already had adverse impacts on reform and may have an adverse impact on future performance of the sector. For example, the Dutch generating sector could become a highly successful competitor in international electricity trade and become net exporters, rather than importers, of electricity. Unfortunately, this potential is undermined by government policies such as reciprocity provisions aimed at protecting incumbents.

*Chapter 6*

# REGULATORY REFORM IN THE TELECOMMUNICATIONS INDUSTRY

The telecommunications industry is extraordinarily dynamic. Rapid evolution of technologies has shaken up industries and regulatory regimes that were long based on older technologies and market theories. Twenty-three OECD countries have unrestricted market access to all forms of telecommunications, including voice telephony, infrastructure investment and investment by foreign enterprises, compared to only a handful a few years ago. The industry itself is blurring and merging with other industries such as broadcasting and information services.

***Strong competition policies and efficiency-promoting regulatory regimes are crucial to the performance and future development of the industry.***

While the role of regulatory reform in launching and shaping the rapid evolution of the industry has been described by some as pivotal, and by others as at best supportive, strong competition policies and efficiency-promoting regulatory regimes that work well in dynamic and global markets are crucial to the performance and future development of the industry.

***In telecommunications, the Dutch have liberalised even faster than EU requirements, a move which has paid off through entry of many new firms.***

The Dutch telecommunications regime is relatively liberal, with no barriers to entry, no line-of-business restrictions and few controls on prices. In telecommunications, the Dutch have liberalised even faster than EU requirements, a move which has paid off through entry of many new firms. The main regulatory challenges today are to manage the presence of a dominant incumbent and to design regulatory regimes consistent with the convergence of telecommunications and broadcasting.

## Liberalisation proceeded faster than European requirements...

Telecommunications reform in Europe has been driven by EU policies. A process that began with a green paper in 1987 culminated in the directive to open the EU telecommunications market to full competition by 1 January 1998. The Netherlands comfortably beat that deadline in opening its own markets.

***After eight years of steps, the market opened to competition for all forms of voice telephony in 1997.***

Liberalisation began in 1989, with a decision to corporatise the state monopoly, KPN, and open markets for terminal equipment and value added services. In 1993, competition was allowed for data transport and simple resale of leased line capacity. In 1994, other operators were permitted to provide voice telephony service in closed user groups. At the same time, KPN was partially privatised,

through a sale of 30 per cent of government shares. KPN still had a monopoly on analogue mobile service. To introduce competition there, in 1995 new licences for digital GSM mobile services were issued to KPN and to a new entrant, Libertel. In 1996, competition was permitted for satellite networks and communications services (except for voice telephony), and for using cable television networks and other kinds of existing and new alternative fixed infrastructure for telecommunications. Finally, the market was opened to competition for all forms of voice telephony on 1 July 1997.

**... and paid off as many new firms entered.**

In the short time since reform many companies have entered the market, investing in facilities and providing services though, as noted in Chapter 1, KPN continues to dominate the market, accounting for nearly 100, 80 and 60 per cent of local, long-distance, and mobile calls, respectively. In the Netherlands, as in many European countries, domestic liberalisation led to competition between a national incumbent and new companies with connections to foreign incumbents. Some foreign operators entered the market without allying with local firms.

***A large number of entrants are now competing in the domestic market for most services.***

National infrastructure licences were granted in 1996 to two large joint ventures, EnerTel (which includes electric power and cable firms) and Telfort (combining a subsidiary of the state-owned Dutch railways and British Telecom). Both companies already had alternative telecommunications infrastructures. In addition, about 1 400 regional infrastructure licences were awarded in 1997 to around 160 companies, most of which already held permits for CATV or business networks. In 1998, spectrum was allocated for two more national licences, to Telfort and Federa (a consortium of Deutsche Telkom, France Telecom, ABN-Amro, and Rabobank). Existing GSM licence holders, KPN and Libertel, were excluded from the bidding to promote greater competition. Sixteen smaller packages were also awarded. With the addition of a new network built by Tele Danmark,

Box 6.1. **Milestones in telecommunications competition in the Netherlands**

**1989:** Corporatisation of KPN and liberalisation of terminal equipment and value added services.

**1993:** Liberalisation of data communication services and resale of leased lines.

**1994:** Partial privatisation of KPN (30 per cent of shares sold); voice telephony in closed user groups permitted.

**1995:** Mobile services licences issued to KPN and Libertel; another 25 per cent of the shares of KPN sold.

**1996:** Liberalisation of infrastructure and all services except fixed voice telephony.

**1997:** Liberalisation of voice telephony (1 July) and establishment of an independent regulator (1 August).

**1998:** Three new national mobile (DCS1800) licences issued.

the Netherlands may soon have five competing national mobile telecommunications systems.

*Just five years later, more than 100 companies are providing networks or services.*

Before 1994, KPN was the sole company providing fixed or mobile voice telephony services. Today, over 100 companies provide networks or services. Three companies provide nation-wide PSTN services, while five CATV companies have interconnection agreements.

*Prices have dropped most where competition is strongest, but residential charges have increased.*

Prices have changed most where competition has been most intense and long-established, that is, for international and business services and for leased lines, open to competition since 1993. Residential service charges, which are low by OECD standards, have increased as tariff structures have been rebalanced to lower inconnection charges.

**Extensive infrastructure will help speed change, as the CATV network offers an alternative to the local loop bottleneck.**

Although KPN remains overwhelmingly dominant, the possibility of infrastructure competition and strong competition from mobile services means that there are relatively few concerns about the development of effective competition in the near future, assuming a strong government hand in ensuring a level playing field. The Netherlands enjoys virtually ubiquitous CATV networks, extending to well over 90 per cent of the country. By 1999, it is expected that 70 per cent of the cable network will be suitable for two way communication, and this could reach 85 per cent by 2000.

*Rapid convergence among broadcasting, Internet and telecommunications will increase the need for a common authority.*

In the longer term, the rapid convergence among broadcasting, Internet and telecommunications will increase the need for a common, consistent authority. The Netherlands, like most OECD countries, is facing a double challenge: to complete the liberalisation of the telecommunications market while preparing a foundation for the next-generation regulatory regime.

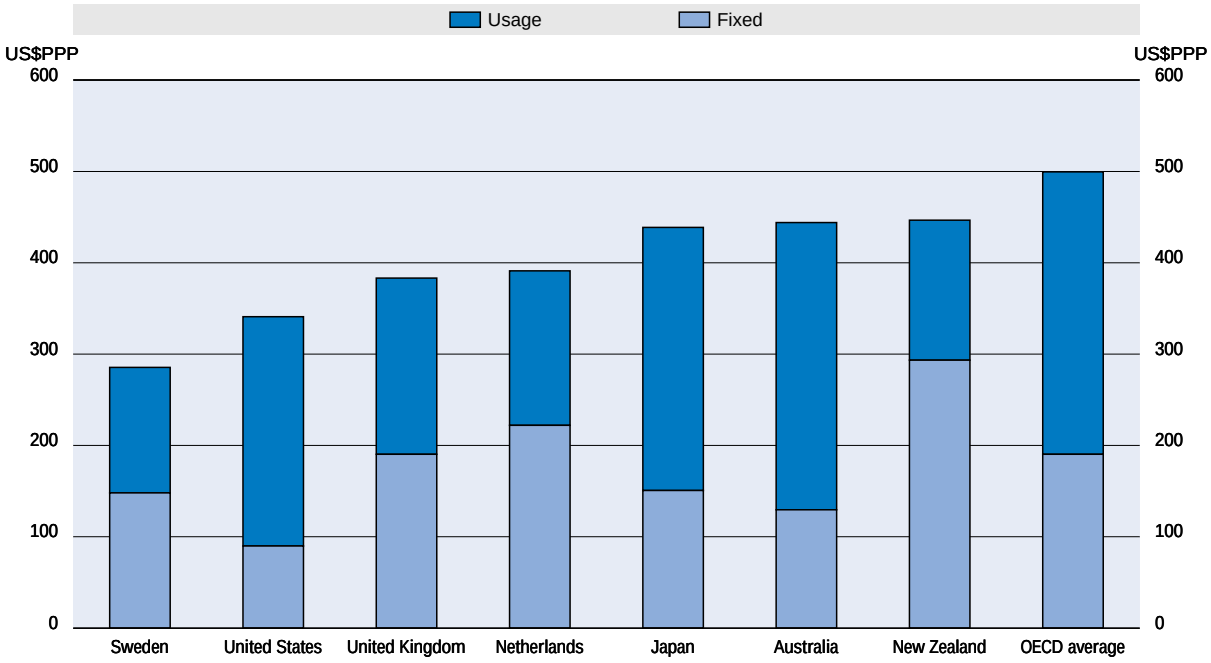
**A new Telecommunications Act took effect in October 1998, aiming at full competition in all telecommunications activities…**

The new Telecommunications Act covers practically all areas of telecommunications regulation, including registration, spectrum policy and management, numbering policy, rights of way, interconnection and special access, open networks, universal service, type approval of terminal equipment, protection of personal data and privacy, and disputes and appeal processes.

*Companies wanting to install a network or provide public services need only register with the regulatory agency.*

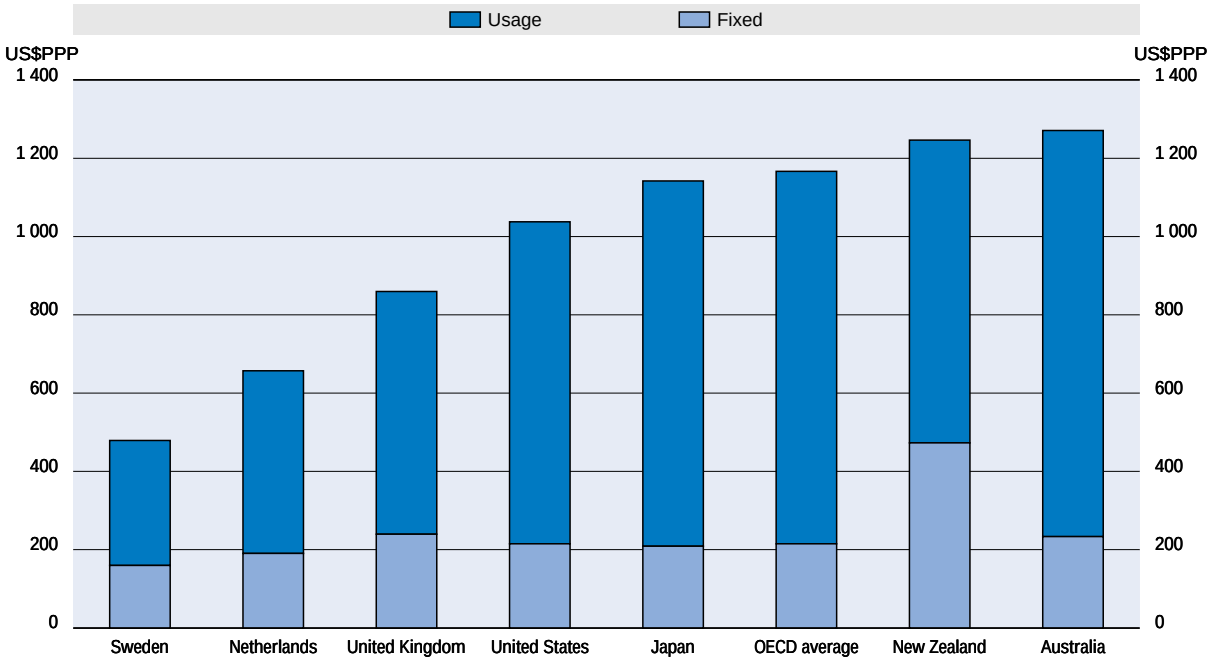
Since July 1997, there have been no restrictions on market entry for network-based telecommunication. Companies wanting to install a network or provide public services need only register with the regulatory agency. Spectrum is subject to licensing, and licenses are issued in the order applications are received unless the Minister decides to apply a competitive test or use an auction. There is no specific regulation of Internet and video on demand services,

Figure 6.1. **Comparison of residential tariff basket (August 1998)**




*Source:* OECD and EURODATA.

Figure 6.2. **Comparison of business tariff basket (August 1998)**






*Source:* OECD and EURODATA.

which are subject only to the generally applicable scheme of open entry upon registration.

Licenses for CATV had been issued as regional monopolies, but as of January 1998 unlimited entry was permitted, both to enhance competition in CATV services themselves and to support greater infrastructure competition for telecommunications. Installation of a network used for broadcasting is subject only to the registration requirement, although broadcasting services are regulated separately, by the Media Act.

*There are no restrictions on foreign ownership and no limits on a single party's share holding.*

The law ensures access to rights-of-way and requires network operators to share facilities, so new entrants can enter the market quickly and cheaply. There are no restrictions on foreign ownership and no limits on a single party's share holding. There are no line-of-business restrictions, although companies offering both telecommunications and broadcasting services must maintain separate accounts for each activity. A single firm can provide both fixed and mobile services.

**… and complete implementation of EU principles.**

*In most important policy issues such as interconnection, licensing, and universal service, EU directives have played a key role.*

These legislative steps, including eliminating restraints on entry and line of business restrictions, are consistent with both the EU Directives and the WTO's February 1997 Agreement on basic telecommunication services. In most important policy issues such as interconnection, licensing, and universal service, EU directives have played a key role. The Netherlands has now implemented virtually all EU directives into national legislation.

The Netherlands is taking a step-by-step approach to ensuring universal service. KPN must offer everyone basic services or facilities at an affordable price. If it wants to end this function, it must give 12 months notice of that intention. If market forces then prove inadequate to provide an acceptable level of universal service availability, a tender process will award the universal service programme to the operator with the lowest price. The cost of paying for the universal service programme would be shared by all telecommunication companies. Because the development of effective competition is likely to reduce the extent of unprofitable regions and the number of unprofitable customers, this "wait and see" approach looks sound. Market forces may eventually deal with the issue adequately.

**Preventing the incumbent from taking advantage of its dominant market position supports effective competition by new firms.**

*The Netherlands went further than the EU Directive in establishing tough standards for interconnection…*

The EU Interconnection Directive obliges fixed network operators with significant market power to provide cost-based interconnection. Market power is presumed at a market share of 25 per cent, but national regulatory authorities are permitted to find that firms with smaller shares have market power or that firms with larger shares do not. Even before this Directive became effective at the end of 1997, the Netherlands imposed an interconnection obligation on KPN. The

new Dutch act also requires providers with significant market power to offer non-discriminatory interconnection to other providers, to ensure that the interconnection terms these firms offer to other parties are the same as those applied to their subsidiaries. The regulator is to resolve disputes (within six months) if a provider and a firm requesting access cannot agree on terms. There are special accounting rules for interconnection to ensure transparent, cost-oriented, and unbundled tariffs.

***… and the level of interconnection charges is consistent with best current EU practice.***

Interconnection charges are now based on embedded direct costs, a modified forward-looking long-run incremental cost system. The level of interconnection charges is consistent with best current EU practice. In April 1998, KPN was required to remove charges in its interconnection tariffs that tried to recover the cost deficit in the line rental through charges paid by competitors.

The Ministry allocates spectrum by issuing licences. Spectrum licenses are transferable, as a practical matter. The Ministry appears to prefer using the auction method, rather than first-come, first-served method, but this has led to some distortions. Entrants have paid high prices for licenses, to compete against incumbent firms that did not incur that cost. But the Ministry's effort to equalise the competitors' positions, by making the incumbents pay for what they already had, was successfully challenged before the European Commission.

***KPN must maintain "accounting separation" between fixed and mobile services to guard against anti-competitive cross-subsidisation.***

Because of its dominance, KPN must maintain "accounting separation" between fixed and mobile services to guard against anti-competitive cross-subsidisation. And to foster new network investment and prevent the leveraging of market power into newly developing product markets incumbents have been subject to a some line-of-business restrictions. KPN was asked to reduce its share holding of the major cable firm, Casema, so it would not control both telecommunication and CATV infrastructures; in response, KPN sold all of its cable holdings, to France Telecom. And in the 1998 DCS 1800 auction process, the incumbents KPN and Libertel were prohibited from bidding.

***The Dutch government moved quickly to implement number portability.***

The Dutch government has moved quickly to implement number portability, for mobile as well as fixed services, and carrier pre-selection. New entrants will thus enjoy equal access to final customers.

**A new independent regulatory body, OPTA, shares authorities with the Ministry.**

EU telecommunications legislation requires the establishment, as of 1 January 1998, of national regulatory authorities in the member states. This regulatory body must be legally distinct and functionally independent from telecommunications organisations. Accordingly, the Netherlands established a new regulatory body, OPTA (*Onafhankelijke post en telecommunicatie autoriteit*), in August 1997. This body makes decisions independently.

*OPTA is responsible for market supervision, while the Ministry handles policy.*

The Minister of Transport, Public Works & Water Management remains responsible for policy matters, establishing the frequency and numbering plans, granting spectrum licences, and ensuring universal service. OPTA is responsible for supervisory and market-oriented executive tasks, including administering the registration system, issuing numbers; supervising compliance, identifying operators with significant market power, and resolving disputes about interconnection and rates.

*Jurisdiction over competition policy problems is assigned to the new competition enforcement body.*

OPTA is principally a regulator, but its decisions may have competitive implications, and thus co-ordination with competition policy institutions is important. Jurisdiction over competition policy problems such as anti-competitive agreements and mergers, in telecommunications as well as other industries, is assigned to NMa, the new competition enforcement body. There is an exemption from the competition law, however, for conduct that is, or could be, regulated by another body, including OPTA. OPTA's regulatory role and NMa's competition policy responsibilities might sometimes converge. For example, OPTA identifies firms with significant market power and then applies the necessary special oversight rules to them, while NMa enforces the law against abuse of dominance.

*Consulting on licence transfers would help ensure consistency and efficient application of competition policy.*

Conflict has not yet arisen, though, and the agencies are taking steps to reduce the risk. OPTA and NMa are required to reach agreement on general guidelines about competition, although OPTA decides independently about anti-competitive conduct that is regulated by the telecommunications act. OPTA and NMa are sharing information, doing joint policy-related research on issues such as cross-subsidisation and pricing, and developing a protocol on co-operation for the development of competition principles. NMa must be consulted before the Minister makes certain decisions concerning mobile licences, but not about license transfers. Extending the consultation obligation to transfers would help ensure consistency and efficient application of competition policy.

**The government and OPTA will need to remain key players until markets are sufficiently competitive.**

*Prospects are very good that strong competition will develop, but strong regulatory oversight will be needed during the transition phase.*

The Netherlands telecommunications market has been substantially opened, and prospects are very good that strong competition will develop. But due to KPN's high market share, the potential for discouraging new entry and effective competition will remain a risk for some time. The degree of flexibility to be used in applying regulation during the transition to competition is unclear. OPTA can waive application of regulations for some subjects, such as the requirement for uniform tariffs, but there are no explicit forbearance provisions. OPTA's performance and existence will be reviewed by Parliament in 2002. Otherwise, there are no requirements to undertake a regular assessment of the need to streamline regulation. Sector specific regulation can assist in the transition phase from monopoly to competition, but as market forces become stronger, the sector specific regulation will need to be phased out.

**In some respects, the regulatory hand remains too heavy…**

One asymmetric obligation concerns interconnection. Firms with significant market power are obliged to provide "special access" at points other than the usual ones offered to most network users, in response to reasonable requests. This has been interpreted to mean full access at every feasible point in the public network. Forcing a firm to make its facilities available to a competitor at regulated prices is a significant regulatory intervention whose scope should be strictly limited. It poses serious dangers of distorting incentives for investing in improved facilities or research and development. Special access should only be granted to what are clearly "essential facilities".

***Lifting the uniform tariff obligation will encourage price competition and ultimately benefit customers.***

Another concerns prices. In general, prices are not regulated. But some of KPN's tariffs, for voice telephony and leased lines, must be based on costs. And KPN must charge a uniform tariff over the entire country. It will not be allowed to differentiate tariffs between regions until there is sufficient competition. By contrast, KPN's competitors can differentiate by region and by customer, and they thus may have an advantage in low-cost markets like the urbanised Randstad. Despite the market distortions that result, the Dutch government appears to believe that abandoning this asymmetric approach now would raise concerns about the risks of entry; moreover, permitting regional variation would be politically unpopular. But as alternatives develop, the uniform tariff will prevent efficient cost-based pricing. Lifting this uniform tariff obligation will encourage price competition and ultimately benefit customers.

***Price-caps should be reinstated as soon as practicable.***

In the past, KPN was subject to price cap regulation. Separate caps applied to an "overall basket" of services and a "small-user" basket. But the caps were lifted when KPN was required to move to cost-based tariffs in July 1997. This use of rate of return regulation is said to be temporary measure, to bring prices closer to costs and establish a reasonable starting point to re-introduce price caps. In the meantime, the regulator is using cost-based rate-of-return controls to achieve rapid rate rebalancing. Rate of return methods can encourage inefficient behaviour and discourage risk-taking investment. Shifting back to price caps as soon as practicable would avoid these problems and establish a more stable foundation for planning.

As a general rule, interconnection requests from foreign companies are treated like those from local companies. There is an exception, though. If cross-border interconnection would result in a "distortion of competition", the Minister can exempt providers from the obligation. This exemption of interconnection obligation is an *ex post* measure whereby the requested party should prove that the market is distorted because of actions of a foreign operator. Since the burden of proof lies on the requested parties, it is not likely that foreign operators would face difficulties to access to local companies' networks in order to terminate their calls. In addition, general competition rules are applicable when the Minister decides whether actions of a foreign operator cause a "distortion of competition".

**… and institutional structures are not yet likely to yield maximum benefits.**

The state still has a significant stake in two national licensees, through its direct minority share of KPN and through its ownership of a major shareholder in Telfort. Experience in other countries has shown that conflicts can arise between the government's interests as a shareholder and its concerns as a policy maker and regulator. Reducing the government's shares in these firms still further should be considered.

The Ministry retains some non-policy functions, such as spectrum allocation. In principle, assigning those market functions to the Ministry increases the risk of uncertainty in the market, and conflict between the different roles of the government as a regulator and a shareholder. Spectrum licences should be issued as transparently and independently as possible. Although responsibility for establishing the overall frequency plan could be retained within the Ministry, responsibility for granting licences should be devolved to OPTA.

To ensure competition in the developing telecommunications markets, sectoral regulators have imposed conditions in particular situations, such as requiring KPN to divest its cable interests and preventing the incumbents from bidding in the DCS 1800 spectrum auction. In general, where there are concerns about market power, these concerns should be dealt with through competition policy institutions. These particular decisions were taken before the new competition policy institutions were in place, but now there is a modern competition law and an independent enforcement body, and issues like these should be handled under the generally applicable rules and procedures.

**Regulation must recognise the convergence of telecommunications and broadcasting.**

***The Netherlands should consider establishing a regulatory body that supervises both telecommunication and CATV.***

Content is regulated by the Ministry of Education, Culture & Science and the Media Commission, but OPTA has certain responsibilities in the broadcasting sector. In particular, OPTA decides on disputes between CATV companies and program providers. Considering the trend toward convergence between telecommunications and broadcasting, it is opportune for the Netherlands to have a regulatory body which supervises both telecommunication and CATV.

Even though the Netherlands is still establishing a new regulatory framework for telecommunications, the rapid convergence among broadcasting, content and communications technologies and services requires consideration of appropriate regulation for the next generation. Differences in regulatory treatment of the different sectors may already be distorting investment decisions and preventing users from enjoying better services. A challenge is to move speedily from service-specific regulation to regulation based on competition policy principles, to ensure regulatory consistency between converging sectors. At minimum, closer co-operation among regulatory institutions is needed, to determine common policy goals.

*Chapter 7*

# CONCLUSIONS AND POLICY OPTIONS FOR REGULATORY REFORM IN THE NETHERLANDS

***Regulatory reform supports sustainable economic and social progress in the Netherlands by…***

Regulatory and competition policy reforms in the Netherlands have helped to sustain and expand earlier gains from labour and social security reforms. Together, these reforms create the framework for the decades-long evolution of the Dutch welfare state. Regulatory reform has produced major benefits for the Netherlands by:

***… reducing costs in exporting sectors…***

– Reducing the cost structure of exporting, distribution, and transit sectors to improve competitiveness in European and global markets. Increased efficiency has particularly high pay-offs for small open economies such as that of the Netherlands.

***… improving innovation and flexibility…***

– Addressing the lack of flexibility and innovation in the supply-side of the economy, which will be an increasing constraint to growth. Rigidities are especially costly in opening European markets where competition is intensifying, and will further intensify under the single currency.

***… boosting consumer benefits through lower prices and more choice…***

– Boosting consumer benefits by reducing prices for services and products such as electricity, transport, and health care, and by increasing choice and service quality. The convenience of longer shop hours, for example, has been welcomed by consumers.

***… increasing employment rates and reducing fiscal outlays…***

– Helping to increase employment rates by creating new job opportunities, and by doing so reducing fiscal demands on social security programmes, particularly important in an ageing population. Positive employment effects will be limited, however, without further reforms to the social security system, further labour market reforms, active measures to reintegrate the large stock of disabled workers, and further upskilling of the workforce.

***… and maintaining high levels of regulatory protections.***

– Maintaining and increasing high levels of regulatory protections in areas such as health and safety, the environment, and consumer interests by introducing more flexible and efficient regulatory and non-regulatory instruments, such as market

approaches. Reforms that enhance policy responsiveness allow the administration to react to rapidly changing environments and new policy problems.

This review, in examining the contribution of regulatory reform to the policy mix, provides guarded support for the conclusion that negotiated policy reform is in many cases an effective tool in reforming the Dutch welfare state, but that policy responsiveness and adaptability require improvement. Finding the right balance between domestic consensus and timely policy adjustment is a continuing challenge.

**The combination of competition, market openness, and regulatory quality shows potential as an effective policy mix for improving economic dynamism, while maintaining protection.**

***Market liberalisation has been balanced with attention to producing good regulations where needed.***

The main emphasis of the Dutch reform program has been on stimulating economic performance through liberalisation and effective competition policy, but this has been balanced with important reforms aimed at producing good regulation – cost-effective, simple, and enforceable – where that is needed. Reform of the electricity industry, for example, combined liberalisation with market-based schemes for expanding use of "green" energies. These reforms show a close and supportive relationship between quality regulation, competition, and market openness in achieving economic and social policies. Dutch experience with the MDW programme suggests that regulatory reform is more sustainable and produces greater benefits in economic and policy performance when these dimensions are integrated.

***Benefits of policy responsiveness and regulatory efficiency are larger for small, open, export-driven economies.***

The market openness dimension is more important in the Netherlands than in some other OECD countries. The benefits of policy responsiveness and regulatory efficiency for small, open, export-driven economies like that of the Netherlands are amplified when external constraints and opportunities are changing rapidly. Reducing the costs and efficiency drags of poor regulations supports faster adjustment to changing conditions in European and international markets.

***Effective consumer protection has been shown to be important in parallel with economic deregulation.***

The regulatory quality dimension, too, is crucial. Even where social anxieties are high, the search for better regulatory solutions continues through a pragmatic, results-oriented approach that has improved over time. Attention to consumer protection and concerns was neglected early in the MDW programme, part of the reason for delays in implementation, but effective consumer protection has been shown to be important in parallel with economic deregulation. Fears about the effects of reform on regulatory protections have not been borne out, but continued reform will proceed faster and more deeply if reformers take concrete steps to demonstrate that protection has been maintained and necessary regulations are well-enforced.

**A comprehensive approach produced more benefits. Regulatory reform was more effective when integrated with flexibility in other markets and when the macroeconomic environment was geared to growth.**

*The good performance of the Dutch economy is due to fiscal consolidation and wage moderation, combined with structural reforms…*

The good performance of the Dutch economy in recent years is the result of macroeconomic adjustment (fiscal consolidation and wage moderation) combined with structural reforms, illustrating the benefits of pursuing both concurrently. Structural reforms affected multiple policy areas simultaneously, generating positive synergies and spillovers. Important reforms in labour markets and social policy were reinforced by tax reductions and regulatory reforms that provided better incentives for employment, generating greater job opportunities and improving competitiveness and overall growth.

Regulatory reform can continue to boost performance. The impact of reform in selected product markets, particularly service sectors, can be substantial, and will have greater positive effects if complemented by further labour market reforms. Increasing the flexibility of work and relative wages and reducing work disincentives will increase the employment impact of product market reforms and the overall utilisation of the labour force, allowing for greater overall output.

**Economic performance has been good but can be improved by correcting structural problems.**

*… but there is no room for complacency.*

Reforms have improved Dutch economic performance, but there is no room for complacency. To some extent, improved performance represents a one-off recovery effect from previous poor performance, so positive impacts on future growth may diminish steadily. Despite progress in social and labour market reforms, more is needed. Non-employment and long-term unemployment rates remain high, and a relatively large share of the population receives social benefits, lowering actual and potential output. These reforms may be the most politically painful, difficult and slow.

*The evidence provides an early warning that supply-side problems will create an increasing drag on growth…*

Few sectors in the Netherlands are very inefficient; in fact, some sectors are productivity leaders and most sectors are performing at or above European averages (though perhaps below levels in the United States, often the productivity leader). But remaining supply-side rigidities and inefficiencies will create a drag on growth that will become more apparent as the effects of labour market reform diminish. Because price flexibility is low, for example, economic adjustment requires changing quantities, not prices. This was demonstrated by the slow reduction in unemployment in the aftermath of the economic slowdown of the early 1990s, and shows that the progress on unemployment is fragile. Adaptive capacities and resistance to shocks are increasingly important as markets transcend national borders and continental boundaries.

*… and that the unfinished agenda is long. Further reform will boost macroeconomic performance.*

Further sectoral reforms can have a substantial impact on macroeconomic performance, around 1.5 per cent of GDP according to most estimates. Van Bergeijk and Haffner (1996) estimate that removing supply-side rigidities could raise annual GDP and employment growth by 0.5 and 0.1 percentage points, respectively, while decreasing inflation by 0.6 percentage points. If reform is combined with further labour market reform, this would increase annual growth by 1.1 percentage points for both GDP and employment, while decreasing inflation by 0.7 percentage points. More recent work on regulatory reform (OECD, 1997), though more tentative, estimated that regulatory reform in five key sectors could increase output by 1.6 per cent. These estimates are supported by several other studies (see Table 1.1).

**Dutch incrementalism has produced slow but, in many cases, steady progress. New methods of marrying consensus with greater policy responsiveness to changing conditions are being explored. Evolving Dutch experiences may be valuable to other countries seeking to gain stakeholder support for reform, while avoiding "capture" by special interests and damaging policy rigidities.**

*Dutch reforms are often incremental and advance step by step in a pragmatic and consensual fashion…*

In some ways, the Dutch reform process differs from OECD recommendations. The OECD recommends comprehensive reform in which key decisions are planned in advance and unfold on a clear schedule, but Dutch reforms are often incremental and advance step by step in a pragmatic and consensual fashion. Policy conflicts are often avoided by leaving decisions to later governments or to the public administration. For example, the new competition law did not close exemptions outright, but left the competition authority the discretion to decide on a case by case basis. Reforms are decided in principle, then left to a lengthy process of consultation and consensus-building.

*… but Dutch consensus-building is now being adapted to more the need for more responsive and comprehensive reforms.*

The incremental approach is slow, but has produced some good results. It is likely that incrementalism works better in the Netherlands than in most countries, for two reasons. First, Dutch policy transparency and stability, resulting partly from stable coalition governments and consensus-building in corporatist processes, make reform commitments credible. Major policy reversals are rare. Communication with affected interests is generally good. Just as important is the value of the European single market as a complement to incremental Dutch reforms. European-level reforms speeded up regulatory reform and provided a general policy framework that improved coherence. However, even in the Netherlands, incrementalism exacted a high price by slowing up the benefits of reform, increasing the risk of policy incoherence and failure, and increasing uncertainties in the market that have delayed investment and adjustment. For this reason, the MDW programme is itself moving away from incremental approaches to more comprehensive policy reviews, suggesting that it may be possible to marry bolder and deeper reforms with consensus-building processes.

**Regulatory reform in the Netherlands is inextricably tied to the opportunities and constraints in Europe.**

*In the Netherlands, reform accelerated with the integration of European markets under the policies of the single market.*

The European single market programme has been a valuable stimulus for beneficial regulatory and competition reforms in many areas. In the Netherlands, reform began to accelerate with the integration of European markets under the policies of the single market. Fast-moving, dynamic enterprises in traded sectors began to see domestic competition that reduced cost structures and improved efficiency as a strength in Europe, rather than as a threat. The Dutch government notes, however, that some detailed European regulations may not meet Dutch standards for regulatory quality, and that in some areas, such as electricity, European reform may be moving more slowly than the Dutch government would wish.

*Regulatory reform is no longer, if it ever was, an activity that national governments can carry out in isolation.*

These opportunities and constraints illustrate that regulatory reform is no longer, if it ever was, an activity that national governments can carry out in isolation. Much of the national regulation of the Netherlands originates at the level of the European Union. Much of the implementation of regulation is in the hands of municipal and other subnational levels of government. The recommendations in this report may need to be carried out by these other levels of government. A programme of co-ordination of reforms spanning relevant levels of government can help protect and extend the benefits of regulatory reform in the future.

## POLICY OPTIONS FOR REGULATORY REFORM

*Recurring patterns in Dutch regulatory regimes reduce consumer welfare and policy effectiveness.*

This report is not a comprehensive review of regulation in the Netherlands, but the areas reviewed show recurring patterns in Dutch regulatory regimes that reduce consumer welfare and policy effectiveness. Improvements to regulatory responsiveness, transparency, and accountability are needed. Concerns about the complexity, burden, and rigidity of the national regulatory system continue to be voiced. Further streamlining and eliminating of formalities would be useful. For example, administrative barriers to self-employment linked to the tax and social security systems have a negative impact on entrepreneurship, while administrative costs for hiring employees are still among the highest in OECD countries (Hulshoff *et al.*, 1997). Reform has barely touched many areas where consumer choice is restricted, where burdensome requirements discourage market activity, and where innovative instruments can improve performance. This is particularly true in sheltered sectors and in public sector activities. New regulatory challenges have emerged with new technologies in network industries.

This section identifies actions that, based on international consensus on good regulatory practices and on concrete experiences in OECD countries, are likely to be beneficial to improving regulation in the Netherlands. The summary recommendations presented here are discussed in more detail in the background reports to Chapters 2-6, published in this volume. They are based on the

recommendations and policy framework in The OECD Report to Ministers on Regulatory Reform.

***The scope of regulatory reform should be expanded, and its pace accelerated. This may require new working methods to preserve the benefits of consultation and consensus-building.***

***Delays erode the benefits of reform, limit the areas under reform, and raise serious concerns about policy responsiveness.***

Reform proposals have been delayed for years, eroding the benefits of reform, limiting the areas under reform, and raising concerns about future policy responsiveness. The average time taken to initiate and adopt a law is four years, while major revisions can take 10 years. Most of this time is taken in preparation within ministries.[58] Reforms themselves sometimes build in additional steps, lengthening the time needed for results. The length of the process is the key reason that reform has produced so few benefits. Only 9 of 36 regulatory reform proposals started in 1994-1996 had been fully implemented by March 1999; others are still in the pipeline, including reforms with major benefits in areas such as healthcare. As European integration accelerates under the single currency, incapacity to react more quickly could impose substantial costs on Dutch businesses and policy effectiveness.

***The time needed to put proposals into action should be substantially reduced.***

– *The time required for reform proposals to be considered and implemented should be reduced.* Actions have been taken to streamline the role of advisory bodies and parliamentary handling of draft legislation, and these may have had some effect. Review of the effects of recent changes would be useful in considering further improvements. Consideration should be given to approaches in the United Kingdom and Italy to increase the flexibility of the regulatory system by devising alternative ways to amend regulations that address a lack of capacity in the legislature.

***The new competition law can promote and extend reform…***

– *The new competition law should be applied vigorously.* The new competition law could be extremely useful in promoting and extending reform throughout the economy. A sound strategy of enforcement is now in place. The new authority, the NMa, intends to bring significant cases to demonstrate the law's potential and importance, including cases targeting anti-competitive codes of "unfair competition". Successful application will produce useful demonstration effects and build support for reform. Vigorous application of the competition law will also reduce the potential for private behaviour to erode the benefits of market opening policies.

***… but gaps in the law should be closed as soon as possible…***

– *Gaps in coverage of the competition law should be eliminated as soon as possible by terminating all "temporary" exemptions on or before their planned deadlines.* Decisions on the timing of phasing out special provisions – for price fixing for newspapers and resale price maintenance for books and music, and the general "regulatory authorisation" exemption – will measure the seriousness of the Netherlands' commitment to competition. When the transition periods end, so should the exemptions.

***… and the competition authority should advocate reform throughout the administration.***

– *The competition body, NMa, should be authorised to engage in independent advocacy.* Advocacy by NMa within the administration can speed up action in identifying and removing uncompetitive policies and regulations.

***The line ministries should be made accountable for results on regulatory reform through performance standards.***

– *To further speed action, accountability for results should be strengthened within the ministries through development of performance standards for regulatory reform.* The committee headed by the prime minister, and the efforts of the Ministries of Justice and Economic Affairs, have been instrumental in getting reforms underway. Yet this has not been balanced by incentives for ministries to reform themselves. If the scope and pace of reform is to increase, the energies of the line ministries should be mobilised by reforming incentive structures through development of performance standards for quality regulation, and linkage of those standards to fiscal budgeting and other credible review mechanisms. These mechanisms are not yet well developed in OECD countries, but the US Government Performance and Results Act is one model.

***Implementing regulation on electricity is needed as soon as possible…***

– *In the electricity sector, the new Electricity Act and accompanying regulation should be implemented as soon as possible.* Passage of the new Electricity Act was a good step toward liberalisation of the sector, but the decision to delay the implementing regulation will delay market development, investment, and results.

***… and consumers should be able to chose their suppliers faster than contemplated.***

– *In the electricity sector, the regulator should immediately require that access rules permit small customers to aggregate to prepare utilities and customers for the retail market, and the timetable for the introduction of full choice to all consumers should be advanced.* The lengthy transition period in the Dutch reform process and the limitations on aggregation of purchases are unnecessary barriers to the rapid introduction of competition.

***Regulations should be reviewed systematically to ensure that they continue to meet their intended objectives efficiently and effectively.***

***The MDW reviews of regulations should be expanded and carried out systematically.***

– *MDW reviews should be more comprehensive and include the regulatory activities of trade associations and non-governmental institutions like the PBOs.* Regulatory reviews under the MDW project should be continued, expanded, made systematic, and more transparent. Sectors subject to a fast technological change or where regulatory failure is most costly should have highest priority: these include insurance, housing siting and construction, education, environment, broadcasting, network industries, public services such as health care, transport and water, and barriers to entrepreneurship. MDW is moving from case by case reviews to more comprehensive policy reviews, which is positive. The reinvention principle should guide the reviews to improve understanding of interactions between regulations having a cumulative and overlapping impact, originating from different agencies or levels of government. In every area reviewed, emphasis should be given to removing anti-competitive

barriers that are not the best means of reaching policy objectives, to encouraging innovation, to establishing clear accountability for results, and to identifying the most efficient EU/national relationship in the policy area. Consultation with a wider range of affected interests, including consumer interests, should be an integral part of every review. This was a weak aspect of the first phase of the MDW programme.

***Regular reviews and sunsetting should be continuing activities.***

– *Regular reviews and sunsetting should be used to improve policy adjustment over the long-term*. The MDW reviews are one-off processes, but responsiveness requires continual review. The OECD Report recommended that regulations should be updated through automatic review methods, already increasingly used in the Netherlands, and other methods such as sunsetting. Due to its high cost, sunsetting is probably not a comprehensive solution, but when technologies are changing quickly or uncertainty is high, it can reduce the risk of damaging regulatory rigidities. Review processes should be transparent and structured. *In the telecommunications sector, for example, the Netherlands should clarify the objectives and scope for the scheduled review of regulation based on cost-benefit analysis of continued regulation*. Although Parliament will review the independent agency in 2002, details (such as its scope) are unclear.

### *Cost-effectiveness of government action should be increased by strengthening the role of regulatory impact analysis (RIA).*

***Regulatory impact analysis can be powerful means of delivering public services more effectively.***

Regulatory impact analysis, when well prepared, helps increase the net social benefit of regulations, and can be powerful means of delivering public services more effectively. Delivering services more cost-effectively allows more services to be provided. The Dutch RIA programme has significant strengths, such as use of a helpdesk to improve analytical skills in the administration, but results have been disappointing, and further steps are needed.

***A benefit-cost test should be adopted for regulations.***

– *An explicit benefit-cost test should be adopted for regulations, and independent oversight established to promote analytical quality*. The degree of quantification of regulatory benefits and costs remains low in the Netherlands. As shown in the OECD review of regulatory reform in the United States, adoption of an explicit benefit-cost test can sharply improve the quality of regulatory decisions. Experience in other countries shows that independent oversight and quality control is essential if the analysis is to carried out with rigor and consistency. The practical difficulties of a formal benefit-cost analysis suggests a step-by-step approach in which the RIA programme is improved, integrating qualitative and quantitative elements of the analysis, so that over time it better supports application of the benefit-cost principle. The Dutch government has begun an inquiry into the possibilities of adopting an explicit benefit-cost test.

– *Non-regulatory alternatives should be assessed and their use promoted*. The usefulness of RIA in promoting use of cost-effective and market-oriented policy tools will be enhanced if the cost-effectiveness

of feasible alternatives is analysed and compared with regulatory proposals. In particular, the extension of market-based environmental regulation – so important in the Netherlands – needs to be explored further. Experience in other OECD countries with the use of tradable permits and regulatory taxes has been positive and yielded substantial benefits, showing that regulatory reform and competition can be used to promote social goals and efficiency simultaneously.

– *RIA should be made available for public comments*. Release of RIA for public comment is the single step most likely to improve incentives of the regulatory bodies for good analysis, the information needed for good analysis, and the quality of the public debate over the benefits and costs of regulatory actions. The process should be carefully designed so that additional delays are not introduced.

***Trade and investment effects should be assessed.***

– *A consistent practice for assessment of trade and investment effects of proposed regulations should be adopted*. The Business Effects Test (BET) checklist offers a good basis for such an assessment. The effectiveness of BET procedures would be enhanced by opening up the regulatory process to foreign concerns through informal consultations.

***Institutions responsible for competition, regulation, and reform should be strengthened, and policy linkages better co-ordinated.***

A distinctive and positive element of the Dutch regulatory reforms is the creation of several new agencies and offices with statutory responsibility for regulating, reforming, or promoting competition. These new institutions have the mandates, expertise, and incentives to improve regulatory practices. In creating these bodies, the government intended to balance two important and opposing values: *independence* to improve regulatory transparency and shield decisions from political pressures, and *ministerial responsibility* to parliament, an important accountability mechanism. Traditions of ministerial accountability are seen to limit the extent to which major regulatory responsibilities can be moved outside the central government. The resulting institutions are still to be tested, but it is not clear that the balance has been effectively struck. The situation differs among the new institutions, but in some cases, responsibilities are not effectively divided, and problems with policy co-ordination and linkages have not been resolved. If left uncorrected, these institutional problems could weaken regulatory policies in the future. The recommendations below are intended to improve co-ordination and transparency and to separate regulatory from policy functions more clearly, while maintaining ministerial responsibility for overall policy and results.

***The competition authority does not have clear power over decisions with substantial competitive effects.***

– *Application of competition policy in regulated sectors should be clarified to reduce policy uncertainty and risk of failure*. Government recommendations on the competencies of NMa and sectoral regulators are well-conceived, but are badly implemented. NMa does not have clear power over decisions with substantial

competitive effects. The recommendations call for general, not sector-specific, competition rules, and for giving NMa decisive authority in some cases. Implement of the recommendations is necessary. In network sectors, for example, the competition law should apply to mergers, abuses of market power and anti-competitive behaviour to ensure consistent application of competition rule across all industries. In the electricity sector, *vertical arrangements should be subject to competition authority review*. Sector reorganisation is leading to vertical reintegration between generation and distribution/supply. Vigorous oversight is needed by the expert competition authority.

***In some cases, regulatory decisions should be moved from ministries to independent agencies.***

– *In the electricity sector, the new regulator or competition authority should assume the minister's regulatory responsibilities*. Under the new electricity law, the minister retains authority for many sectoral regulatory activities, such as regulation of supply tariffs. *In the telecommunications sector, regulatory responsibilities for interconnection, numbering, universal service and granting spectrum licences should be delegated to the new regulator.* These regulatory functions should be carried out in a manner that is seen by market actors as transparent and non-discriminatory.

***Convergence between industries such as gas and electricity require review of regulatory regimes.***

– *Convergence between industries requires rethinking of regulatory structures. The natural gas sector should be restructured and regulated in the same manner as electricity*. The convergence between the gas and electricity sectors means that the role of Gasunie (a pipeline and supply monopoly which is 50 per cent state-owned) as a potential competitor in the electricity sector could have a distorting effect on electricity competition. *Similarly, the regulatory regime for broadcasting should be reviewed in the light of convergence. In the long term, it is preferable to create a single regulator to supervise the communications sector. In the short term, closer co-operation between regulatory institutions is needed to reach common policy goals.* As convergence integrates the telecommunications and broadcasting industries, differences in regulatory treatment will distort investment and competition.

***Within the administration, regulatory quality controls should be rationalised.***

– *Better co-ordinate regulatory reform and regulatory quality initiatives*. Improving co-ordination between regulatory quality assurance and regulatory reform initiatives could improve the cost-effectiveness of regulations and at the same time speed up the policy process. In particular, the work of the Ministry of Economic Affairs to review and improve the economic impacts of regulation should be integrated with the work of the Ministry of Justice on legislative quality and enforceability.

***In the electricity and telecommunications sectors, further restructuring, regulatory reform, and market-opening would boost consumer benefits.***

***Vertical separation should be promoted in electricity to speed up the emergence of competition.***

– *In the electricity sector, the network regulator should apply requirements for vertical separation stringently so that owners of network assets are encouraged to spin off and/or privatise their generating assets or remaining transmission shares, should monitor closely the unbundling requirement*

*on distribution and supply, and should seek opportunities to encourage early review of these arrangements, notably separation through privatisation*. Transition to effective competition is supported by separating potentially competitive activities from the networks, and restructuring to reduce the market power of incumbents. The continued cross ownership of generation and transmission by the four production companies remains a concern, albeit reduced by government acquisition of a majority share of high voltage transmission. Similarly, the continued single ownership of distribution and supply functions is a concern.

***Electricity imports should not be restricted.***

– *Restrictions on electricity imports should be applied sparingly, if at all*. The reciprocity restrictions, if applied too broadly, would deprive the Dutch market of important efficiency incentives in the early years of the market. Potential efficiency gains in the Dutch market will only be realised if the market expands beyond Dutch borders. *The regulator should encourage the development of compatible transmission access rules, market operations, contract terms and tariffs between the Netherlands and neighbouring electricity systems.*

***Pricing restrictions in telecommunications should be reviewed and lifted as soon as possible.***

– *Restraints on the incumbent telecommunications firm, KPN, to retain uniform pricing should be lifted when consumers in rural areas have sufficient choices for telecommunications services, in favour of allowing cost-based pricing that benefits consumers*. The new telecommunications regime is relatively free of restrictions on entry and exit, but constraints on prices remain. The requirement for KPN to retain uniform tariffs will hinder its ability to compete, promote inefficient entry, and reduce benefits for consumers. Moreover, the Netherlands imposed temporary rate-of-return price regulations on KPN's fixed voice telephony and leased line services to establish a reasonable starting point for price caps. *OPTA should not delay in re-introducing price-caps in 1999* since rate-of return regulation can generate incentives for inefficient behaviour.

***Regulatory powers shared with non-governmental bodies should be tightly controlled to maintain a level playing field.***

***Governments need to carefully supervise the use of delegated regulatory powers to non-governmental bodies.***

A form of regulation widely used in the Netherlands is "co-regulation", or sharing of regulatory functions between government and industry, common to corporatist systems. This has been implemented predominantly through the professional board structure. Industry based regulatory and enforcement systems can have major benefits in terms of cost and effectiveness, but in many countries professional bodies have used this role to limit competition and increase incomes and, hence, consumer prices. The incentives that exist for rent-seeking require that governments carefully supervise the use of such delegated regulatory powers. The new competition law should eliminate or restrict many anti-competitive practices, although surveillance of PBO regulations was weakened in the Parliament. Also, regulation of several professions was considered by working groups under the MDW programme and deregulatory initiatives are in process.

***Government guidelines should be developed on the use of regulatory powers by non-governmental bodies.***

– *Transparency of non-governmental bodies with delegated regulatory authorities should be improved*. A useful step would be development of clear government guidelines on the use of regulatory powers, including issues such as the representation of independent "public interest" advocates, the review role of competition authorities, and the need for specific legislative authorisation of regulatory powers, as well as transparency standards. Guidelines will improve the transparency of these bodies, enhance their accountability to government and the public, including consumers, and maintain market openness.

***Effects of self-regulation on market openness should be regularly assessed.***

– *Effects of self-regulatory activities on competitiveness and market openness should be regularly assessed*. Given the importance of self-regulatory activities in the Netherlands the assessment of trade and investment effects of proposed regulations is equally, if not more, justified at the self-regulatory level than in the government itself.

## MANAGING REGULATORY REFORM

***Evaluation of the impacts of reform and communication with the public and major stakeholders will be increasingly important to further progress.***

The public debate over regulatory reform in the Netherlands is developing, but is still too focussed on economic impacts, particularly short-term adjustment costs, rather than benefits and costs for citizens in general. There is too little information on the results of reform strategies, including their effects on programme effectiveness, costs, economic performance, and distribution of gains and losses. Such information is critical if reform is to enjoy support from citizens who place high value on safety, health, environmental quality, and other values promoted by regulation. The ambivalence of public sentiment is reinforced by concern that regulatory reform may compromise important social values, such as social equity, universal health care, and the environment, or threaten a highly valued aspect of the Netherlands' culture which is best translated as "cosiness". Evaluation of the impacts of reform, building public support, open policy debate, and enhanced public understanding of the need for reform will be increasingly important to further progress.

# NOTES

1. Van Empel, Frank (1997), *The Dutch Model: The Power of Consultation in the Netherlands*, The Labour Foundation: The Hague, September, p. 3.
2. The Dutch economy was and remains one of the most open in the OECD as measured by the ratio of exports plus imports to GDP – 92 per cent in 1970s and over 100 per cent in the 1980s and 1990s. See Table 3.
3. See the OECD Surveys of the period and also Visser (1997), Ch. 2.
4. The government also dictated temporary wage moderation on several occasions.
5. OECD Survey (1984), p. 34. The number of beneficiaries rose at an annual rate of 20 per cent between 1970 and 1982 so that by 1980 social security benefits had increased by seven percentage points to over 20 per cent of GDP. Many firms put redundant employees on disability as it was more generous than unemployment insurance, providing benefits until retirement age.
6. The evidence from the period indicates that Dutch real wages were quite sticky in terms of inflation and taxes. The total burden of direct taxes and other current transfers from the private sector grew, as a proportion of total private income, by 11.5 percentage points OECD *Survey* (1985), p. 43. For a discussion of the stickiness of real wages see p. 15 ff.
7. The depth of the recession made it one of the most severe in the history of the Netherlands as the negative effects of high world real interest rates and falling export demand were reinforced by the high degree of openness of the country and the underlying structural weakness of the private sector.
8. Between 1980 and 1983 investment fell by 23 per cent and real disposal income for wage earners fell by 7 per cent. Much of the decline in wages was a cut in government (and related) sector wages of three per cent.
9. Total government outlays rose around 45 per cent of GDP in the early 1970s to 55.8 per cent in 1979 and nearly 60 per cent during the 1981-83 recession. This increase was more than accounted for by rising social security transfers, other transfer payments, and higher interest payments as the rapidly growing stock of government debt combined with rising world interest rates (see Figure 7).
10. Beginning in 1982 Q3 the central bank did steadily lower interest rates.
11. See Visser and Hemelrijk (1997), pp. 16-20 and the OECD Surveys for 1982 through 1985.
12. Most of this brief summary is derived from the 1998 OECD Survey. See Chapters III and IV "Implementing Structural Reform" and "Reform of the Social Security System" for greater detail.
13. They also encouraged them to hire those on disability pensions.
14. Competitiveness improved by 14 per cent between 1982 and 1985 having already improved by the same amount between 1979 and 1982 thanks to the fall in real wages during the recession.
15. The Netherlands' share of EU non-energy exports fell by one percentage point between 1975 and 1980 to 7.6 per cent, and has remained at that level since. (Despite a pause in 1986-87 export growth averaged nearly six per cent (see Figure 1D).)
16. Private sector employment growth averaged nearly two per cent between 1983 and 1990 and grew particularly rapidly in the service sector. About two-thirds of new employment was accounted for by part-time employment.
17. The per cent increases in various inequality indicators for the Netherlands were relatively large compared to other countries but the absolute increase was small, reflecting the fact that the initial income distribution in the Netherlands was quite flat.
18. This reflects wage and sectoral price rigidities, discussed in the next section.

19. The government targeted annual privatisation revenues for 1987-90 at around ½ per cent of GDP. Cumulative revenues were 12.8 billion guilders from 1983-94.

20. The government privatised the chemical company DSM and reduced its share in the steel company Hoogovens and the national airlines KLM. It incorporated a number of government agencies, including the postal service and printing office. These policies were complemented by devolution and decentralisation to local governments of a number of government services. Privatisation and incorporation were largely responsible for the decline in government employment which began in 1987.

21. See Chapter 2, especially Box 2, for details. In its first year the MDW commission "included the Shop Opening Act, taxi regulations (in public and road transportation), driving time regulations, end [*sic*] the process monopoly of lawyers". (Centraal Plan Bureau, 1997, p. 447).

22. The 1993 OECD Survey included a special chapter on competition policy. A number of products were listed there (p. 71) as lacking in competition in distribution, including optical goods, pharmaceuticals and compact discs.

23. Some of these associations actually have statutory powers to regulate and promote their sector's interests, including levelling membership dues and defining standards.

24. See Chapter 7 for a more detailed discussion.

25. Prices will be regulated for captive customers during the transition period.

26. This measure was developed by the OECD Secretariat and is described in "Performance and Regulation Patterns in OECD Countries", (Annexes 2 and 3) discussed at the Working Party No. 1 of the Economic Policy Committee on 19/20 October, 1998.

27. The countries included are: Belgium, Denmark, France, Germany, Norway, Sweden, the United Kingdom, and the United States.

28. Housing construction or procurement is dominated by local governments and private housing associations. They contract out to construction companies and then sell or lease housing to the public at often subsidised prices. Up until 1995 most of rental housing in the Netherlands was owned by private housing associations or local authorities and subject to price controls. Competition has been limited in that bidding has been highly collusive, with contractors taking turns in submitting winning bids.

29. The McKinsey Study (1997) suggests that as a result of these factors retail prices in a number of sectors may be higher than in the US, even after adjusting for differences in the general price level caused by the VAT, labour costs and tariffs. To the extent that these exist, they may be due to scale advantages in distribution which are not easily replicable in smaller OECD countries.

30. One study, McKinsey (1997), has suggested that there may be cause for concern in financial services. This study argues that there is limited competition in the sector and that this has resulted in a lack of innovation of new products like mutual funds, limiting the depth and breadth of capital markets and therefore their efficiency.

31. The reserve margin is currently around 33 per cent as compared to under 20 per cent in the US.

32. Equipment prices fell by 13 per cent and long-distance telephone prices have dropped by more than 25 per cent on average, with gains of up to 75 per cent expected.

33. See Chapter 6 for details. Tables 6.1 and 6.2 of that chapter show an increase in 1998 because of the introduction of fixed usage charges, but these tables do not accurately reflect changes in offsetting variable costs.

34. This has already been confirmed for 1996 data: following liberalisation retail sales in 1996 rose at rates nearly 4x the growth of GDP.

35. The sales of small stores are forecast to shrink by about 2.4 per cent more than offset by a gain by large stores of 3.4 per cent.

36. See Kremer (1994), and forecasts by the Centraal Plan Bureau (Netherlands Bureau for Economic Policy Analysis).

37. Competition policy is discussed in greater detail in Chapter 3.

38. There are a number of other exemptions to the competition law such as price fixing of newspapers, books and music, (as well as monopolistic sectors subject to sectoral regulators) and a number of sectors have applied to have pre-existing agreements exempted under the new law.

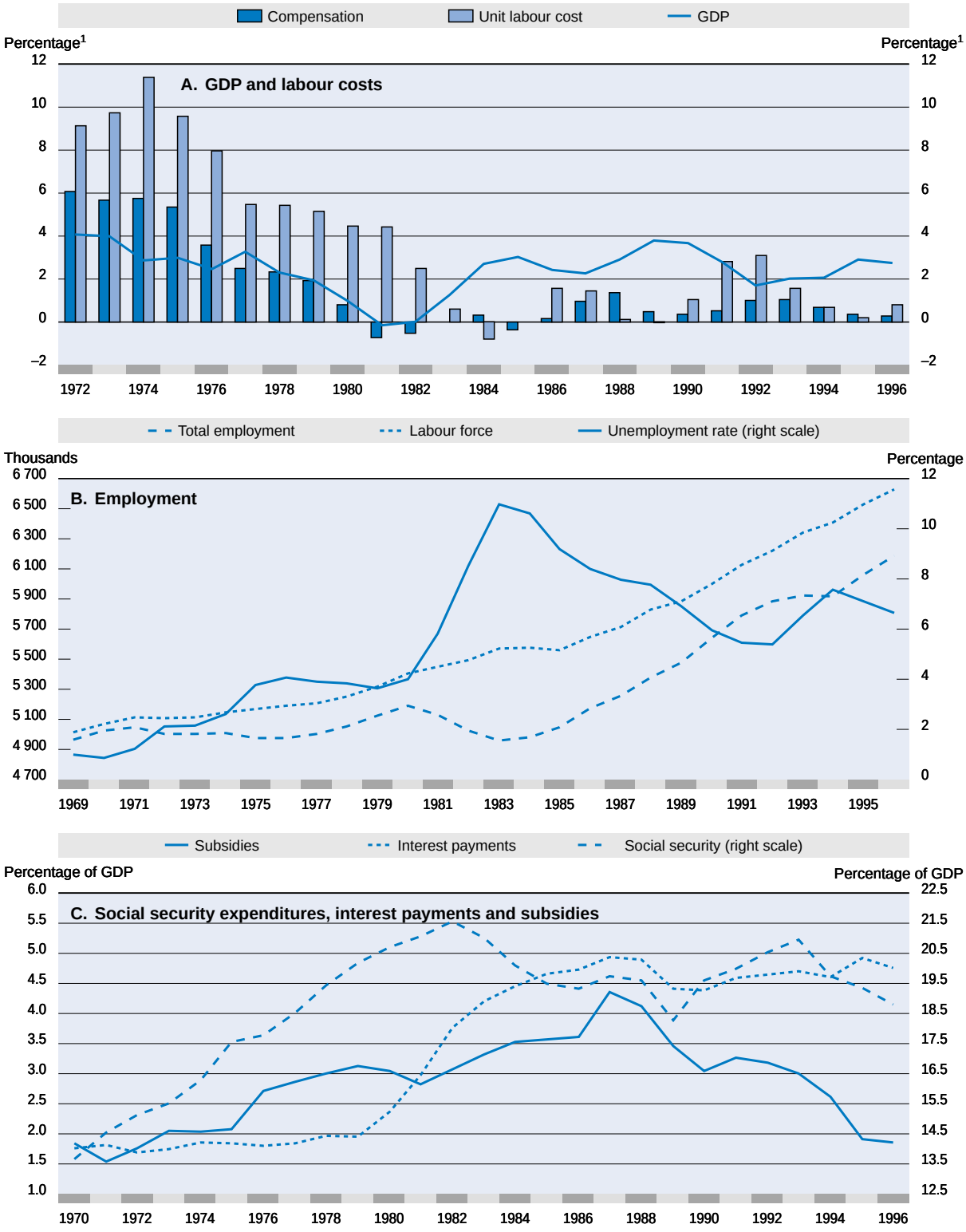
39. Benchmarking, which has been proposed in water and waste treatment and water supply are a poor third option, likely to result in half the efficiency gains of introduction of competition.

40. Estimates are primarily drawn from Haffner and Van Bergeijk (1997), Haffner and Van Holst (1998) and OECD (1997*b)*, Vol. II.
41. The number of trucking firms increased from 8 000 to 10 000 following deregulation, the number of vehicles increased by twenty per cent and capacity doubled.
42. Three companies have entered fixed line voice telephony and three have entered mobile telephony. Substantial additional entry in mobile is expected and CATV cable companies, which have nearly 100 per cent household coverage, are projected to emerge as a significant competitive force in network telephony by 2000, especially in providing Internet service.
43. Additional entry is expected to occur in a number of different forms: large consumers with their own production or acting as co-generators, the new entry of foreign firms taking advantage of abundant natural gas supplies, and increased import foreign competition, especially from France.
44. One study estimates the number of lawyers will increase by 15 per cent.
45. An overview of these analyses is given in Visser (1997).
46. Government of the Netherlands, Ministry of Justice, Legislation in Perspective, p. 29, (English version).
47. NEPP 3 (1998), p. 57.
48. Statement by Klaas de Vries, Chair of SER, meeting with the OECD, April 1998.
49. NEPP 3 (1998), p. 53.
50. Jong (1992), pp. 921-927.
51. Although the agreements are not subject to the general prohibition, NMa may order small firms to terminate them in particular cases if they are found to have a significant detrimental effect on competition.
52. A recent exception being the complaint by the United States to the WTO on "Certain Income Tax Measures Constituting Subsidies", dated 5 May 1998 (WT/DS128/1). Similar complaints were also formulated against France, Ireland, Greece and Belgium.
53. See, for example, the US Department of State 1997 Country Reports on Economic Policy and Trade Practices at http://www.state.gov, the US Department of Commerce "Netherlands Trade Regulations and Standards" and "Netherlands Investment Climate", 21.08.1996, STAT-USA on the Internet (202) 482-1986, the Canadian Ministry of Industry site at http://strategis.ic.gc.ca, the New Zealand Trade Country Profiles at http://www.tradenz.govt.nz, or the American Chamber of Commerce in the Netherlands "Investors' Agenda of Priority Points", The Hague, 1998.
54. See, for instance, US Department of Commerce (1998), "Netherlands Trade Regulations and Standards," at http://www.stat-usa.gov.
55. N.V. Samenwerkende electriciteitsproductiebedrijven.
56. Under the third Environmental Action Plan proposals, released in February 1998, the government is proposing to double the REB in order to encourage increased conservation and to use a portion of revenues raised (500 million Dfl) to stimulate energy efficiency and renewable energy (VROM, 1998).
57. For example, if a major renewable project was delayed, this could lead to an unexpected scarcity of certificates given the lead time for renewables projects. This problem could be compounded if all green certificates had to be handed over on a particular date. There are different techniques to mitigate these effects, such as permitting banking of certificates (*i.e.*, allowing unused certificates to be used in future years), having the Minister hold back a certain percentage of certificates, or futures markets in the certificates (provided there was sufficient liquidity to support this).
58. Algemene Rekenkamer (1994), pp. 27-28.

*Annex*

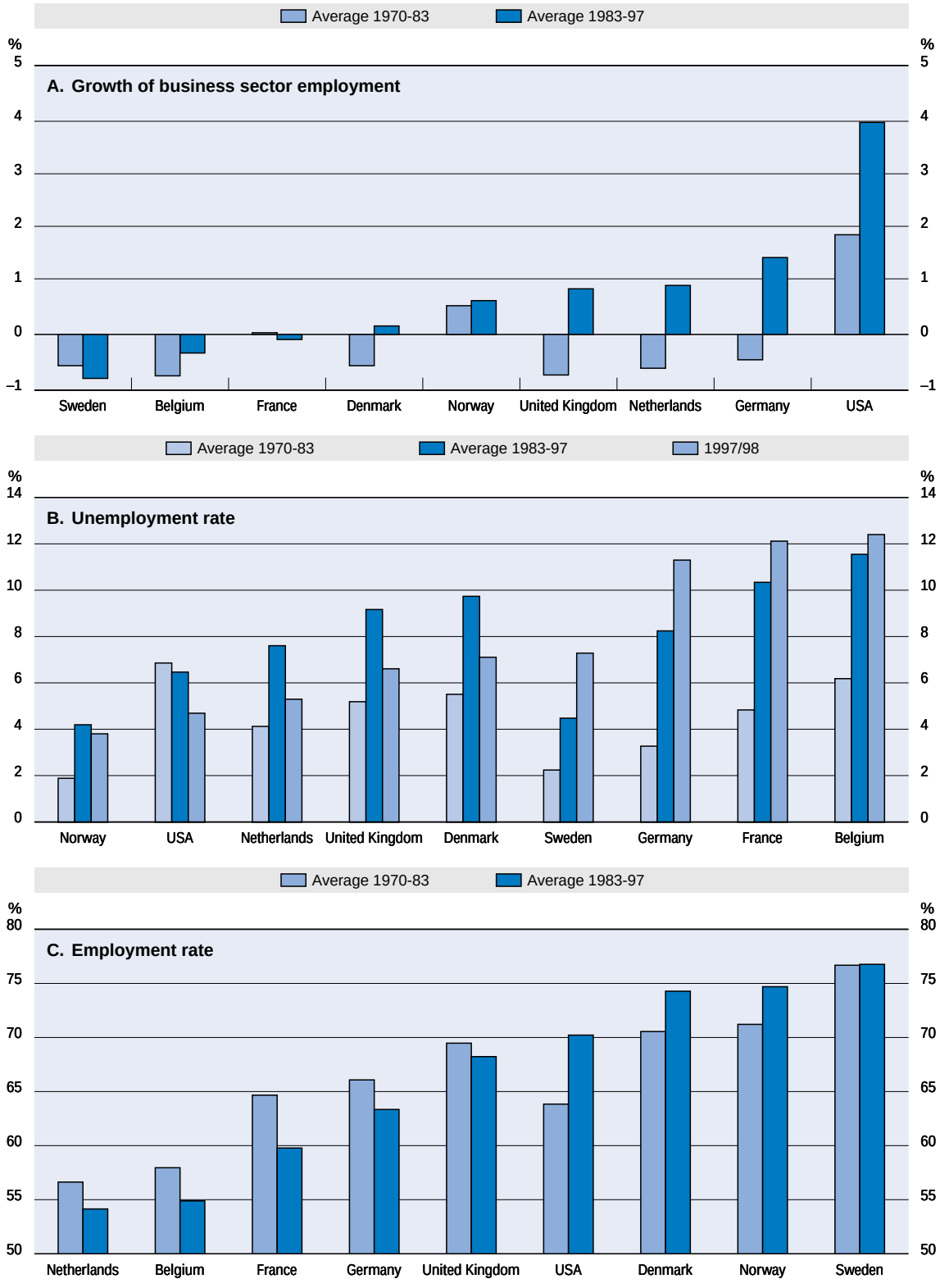
# OTHER FIGURES

Figure 1.1. **Netherlands macroeconomic figures**



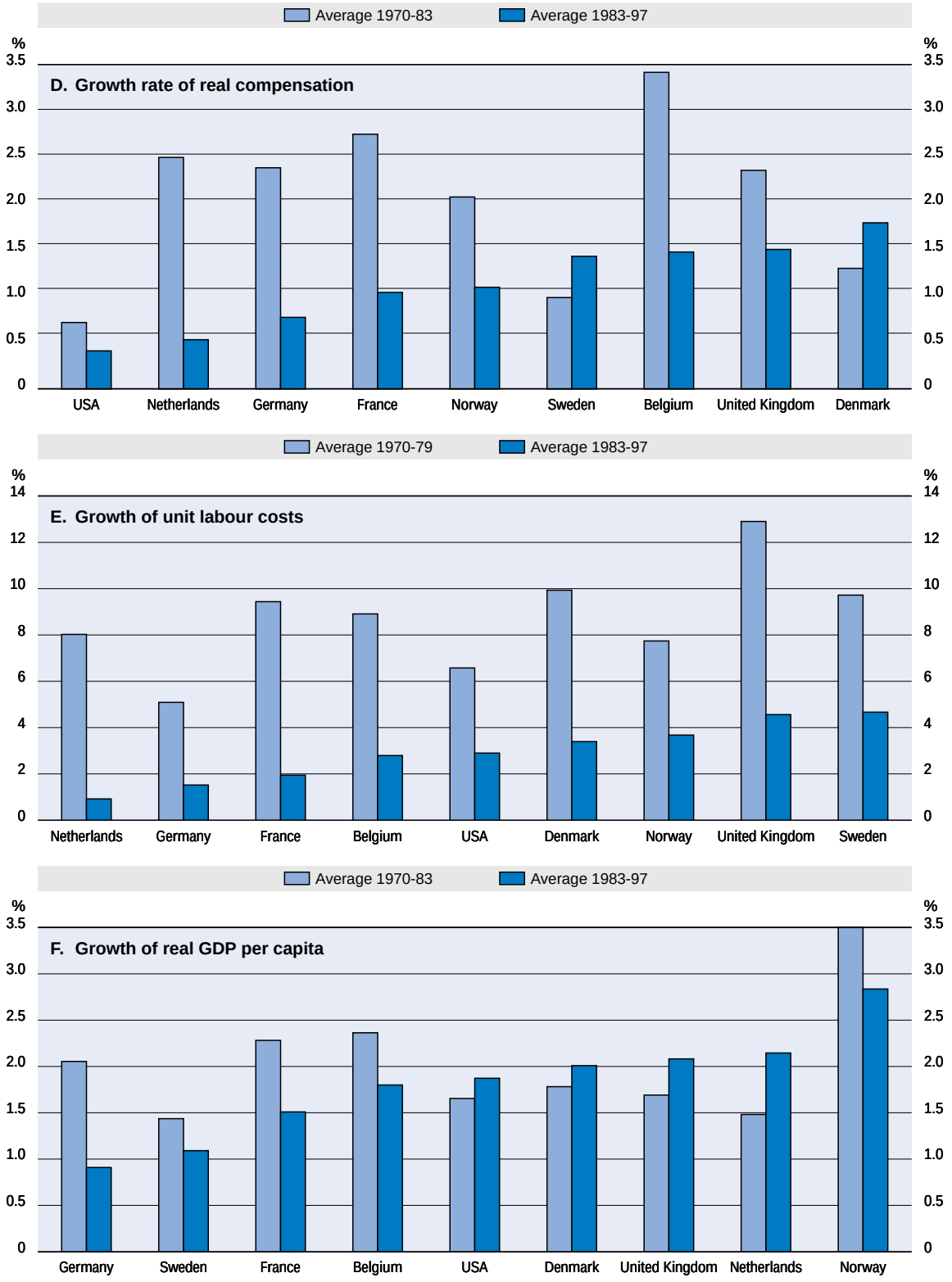

1. Growth rates, 3 year moving averages.
*Source:* OECD database.

Figure 1.2. **Economic performance *vs.* eight OECD countries**



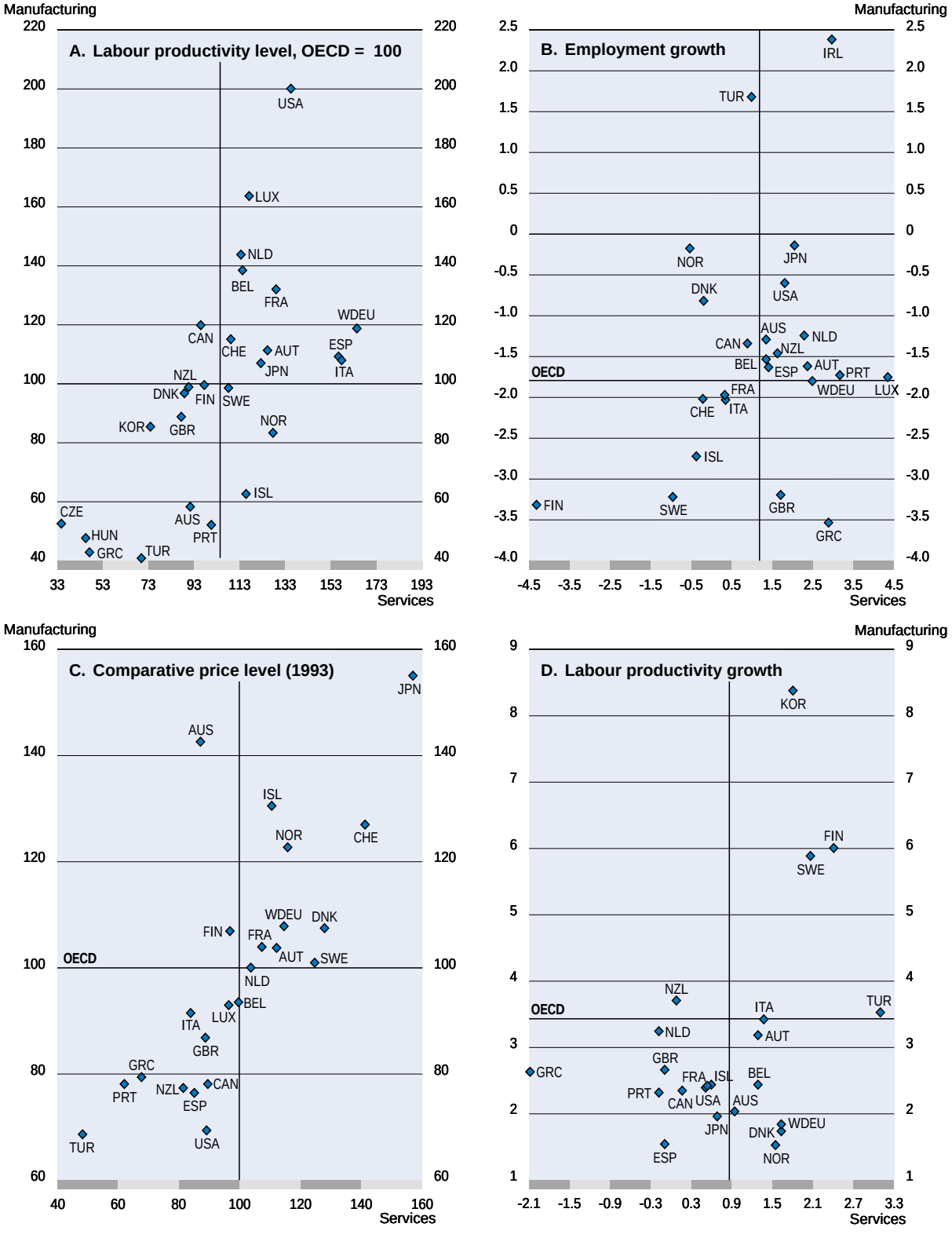

*Source:* OECD database.

Figure 1.2. **Economic performance *vs.* eight OECD countries** *(cont.)*



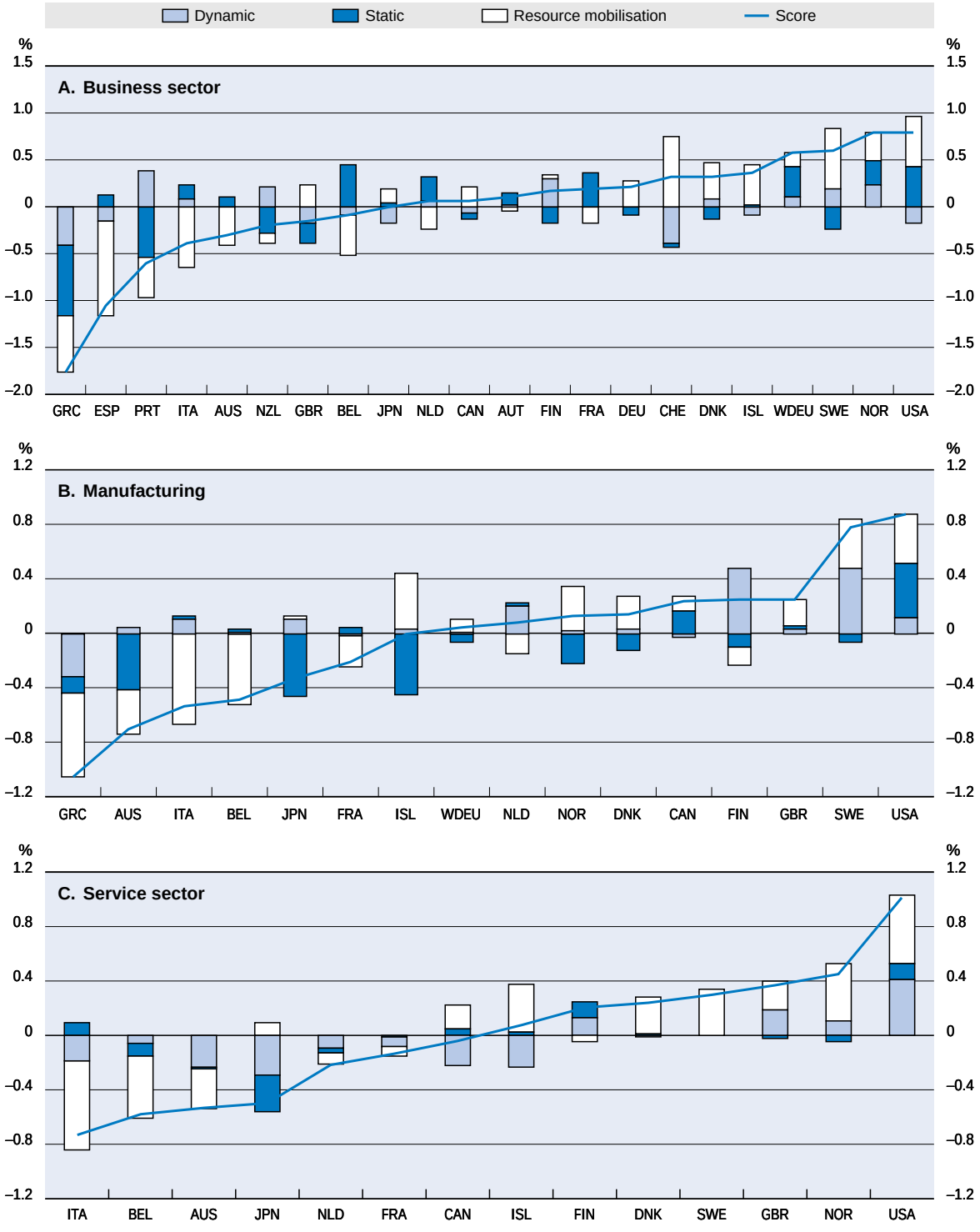

*Source:* OECD database.

Figure 1.3. **Performance in manufacturing and services**
(average 90's)




*Note:* Services defined as non-primary, non-manufacturing industries.
*Source:* Secretariat estimates.

Figure 1.4. **Classification of countries according to overall performance: business and manufacturing sectors**




*Note:* Scores in static, dynamic and resource mobilisation performance reflect the results of factor analysis on the first level indicators corresponding to each sector. Overall scores are obtained weighting factors according to their relative contribution in explaining the total variance of the factors. All variables were standardised prior to estimation.

*Source:* Secretariat estimates.

Figure 1.5*a*. **Netherlands overall performance in manufacturing *vs.* OECD countries**

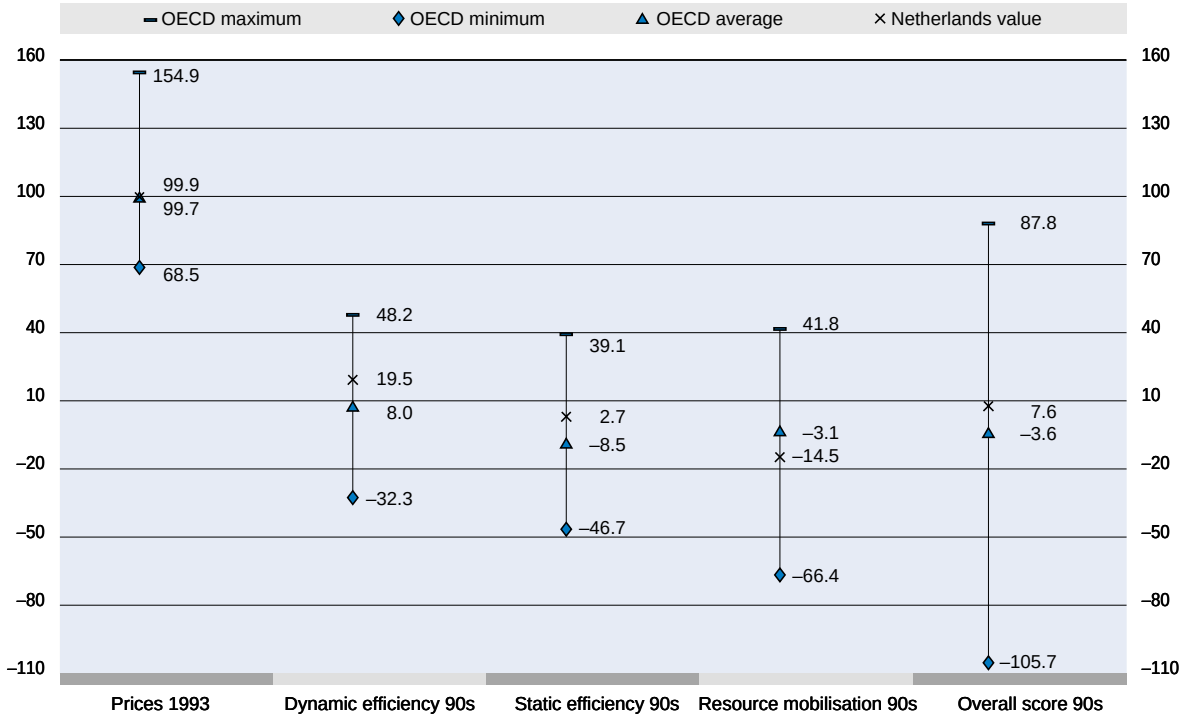
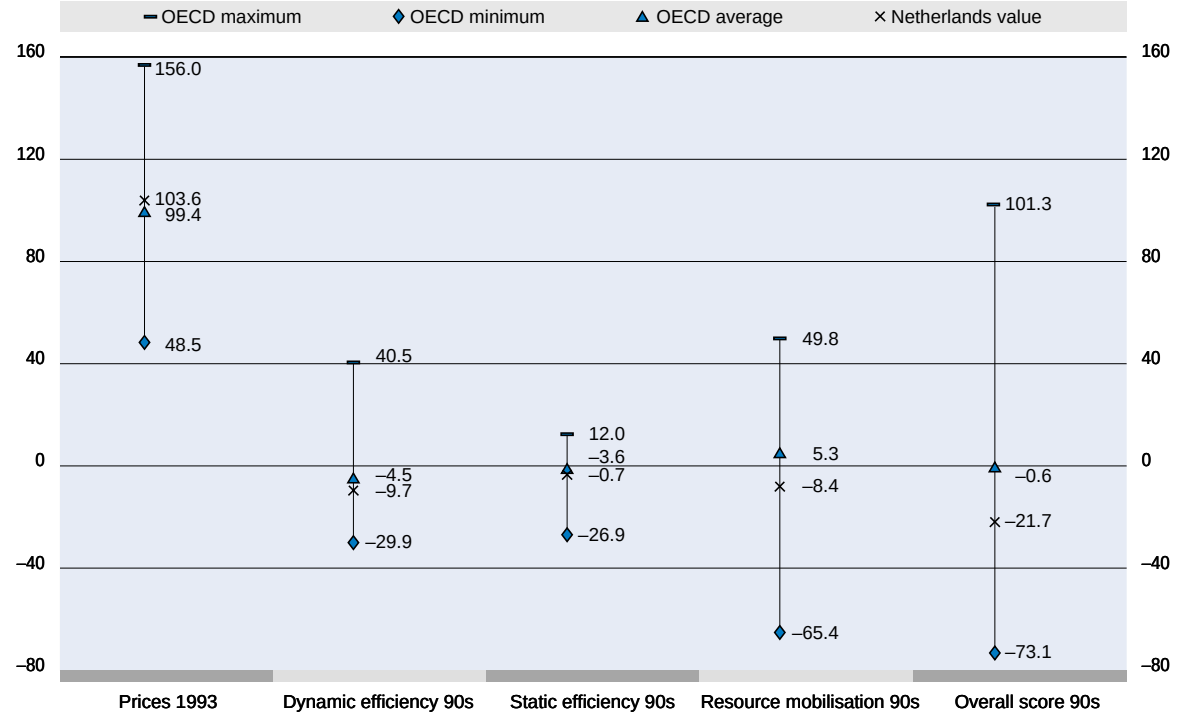



Figure 1.5*b*. **Netherlands overall performance in services *vs.* OECD countries**




*Notes:* For each figure the vertical line covers the range of all values from the maximum to the minimum of the relevant group of countries.
*Source:* Secretariat estimates.

Figure 1.6*a*. **Netherlands growth performance in telecommunications *vs.* OECD countries**

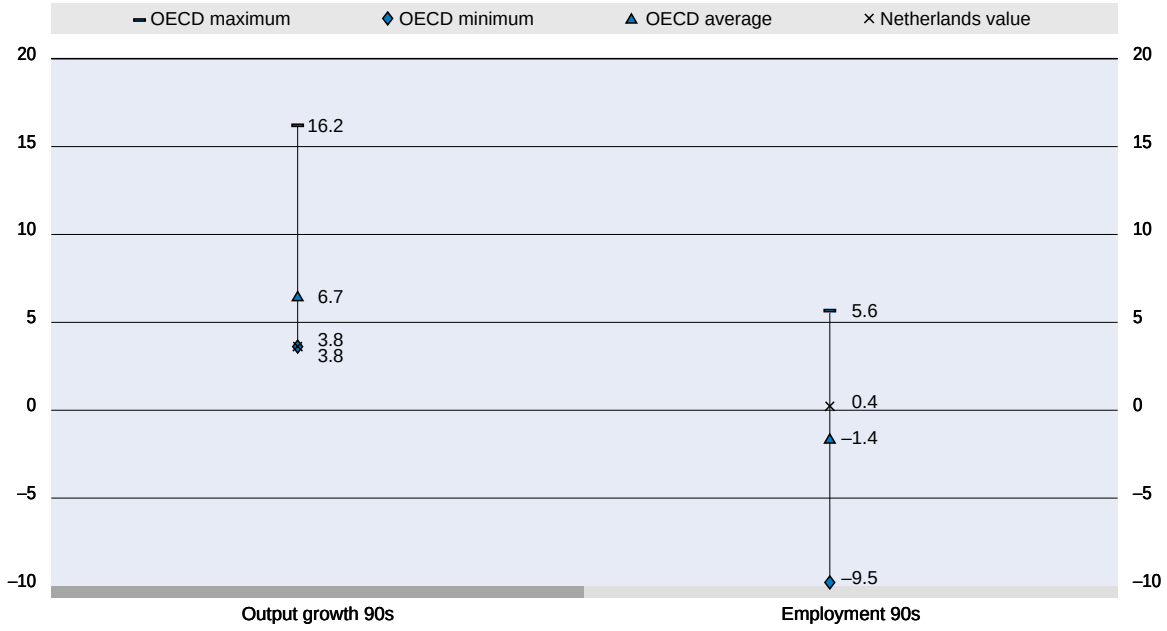
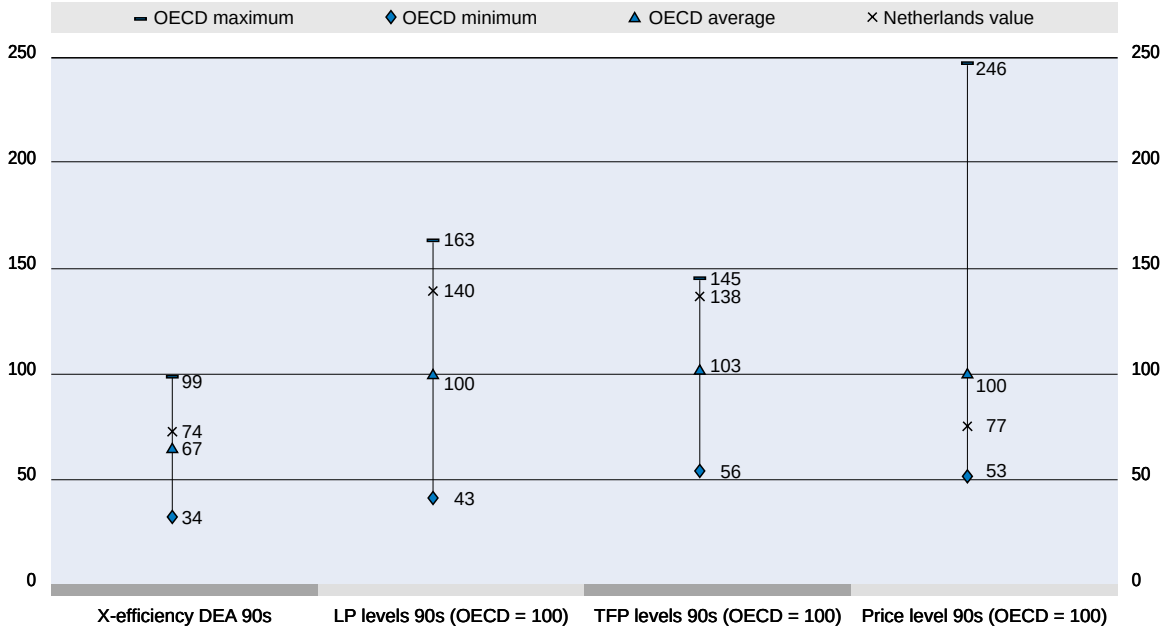



Figure 1.6*b*. **Netherlands performance in levels in telecommunications *vs.* OECD countries**




*Notes:* For each figure the vertical line covers the range of all values from the maximum to the minimum of the relevant group of countries.
Output = mainlines + cellular subscribers.
Employment = total employment.
Labour productivity (LP) = mainlines + cellular subscribers/employment.
Total factor productivity (TFP) = capital is calculated using the perpetual inventory method and the investment PPP (the labour share is set to 0.54 which the OECD average for communications).
DEA = results of data envelope analysis with revenue (converted with sectoral PPP), mainlines + cellular subscribers and number of pay phone as output concepts and employment and capital (as in TFP) as inputs.
Price level = simple average of a basket of services (including business and residential prices of local, trunk and international fixed voice telephony, mobile telephony, leased lines and Internet).

*Source:* OECD Telecommunications database 1997, *OECD Communications Outlook 1997*.

Figure 1.7*a*. **Netherlands growth performance in rail transport *vs.* OECD countries**

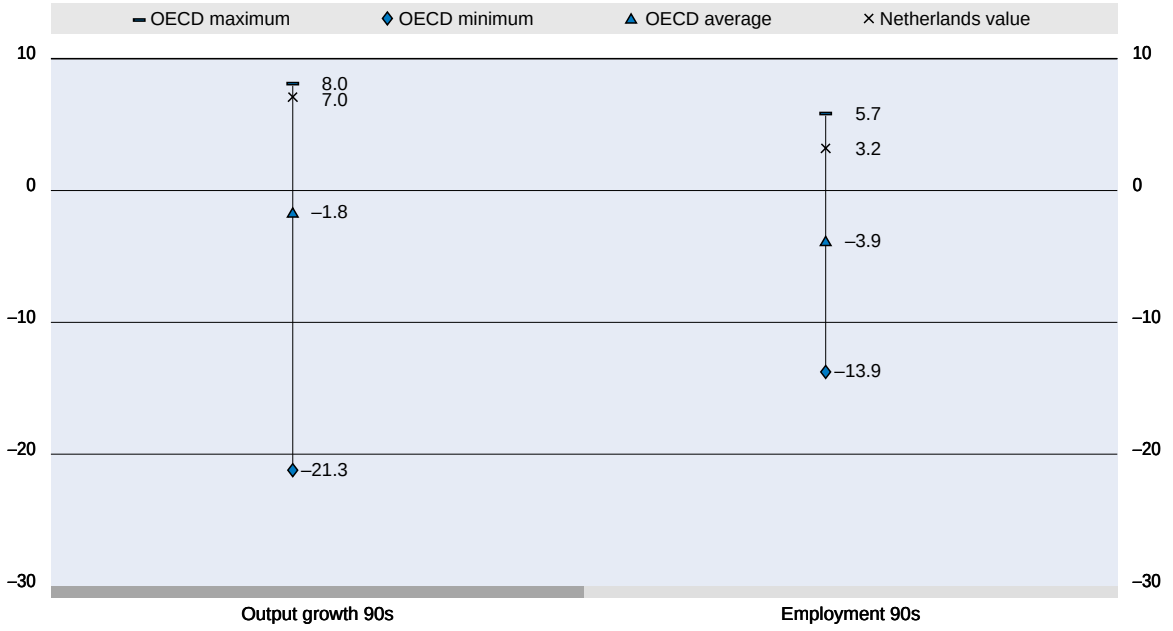
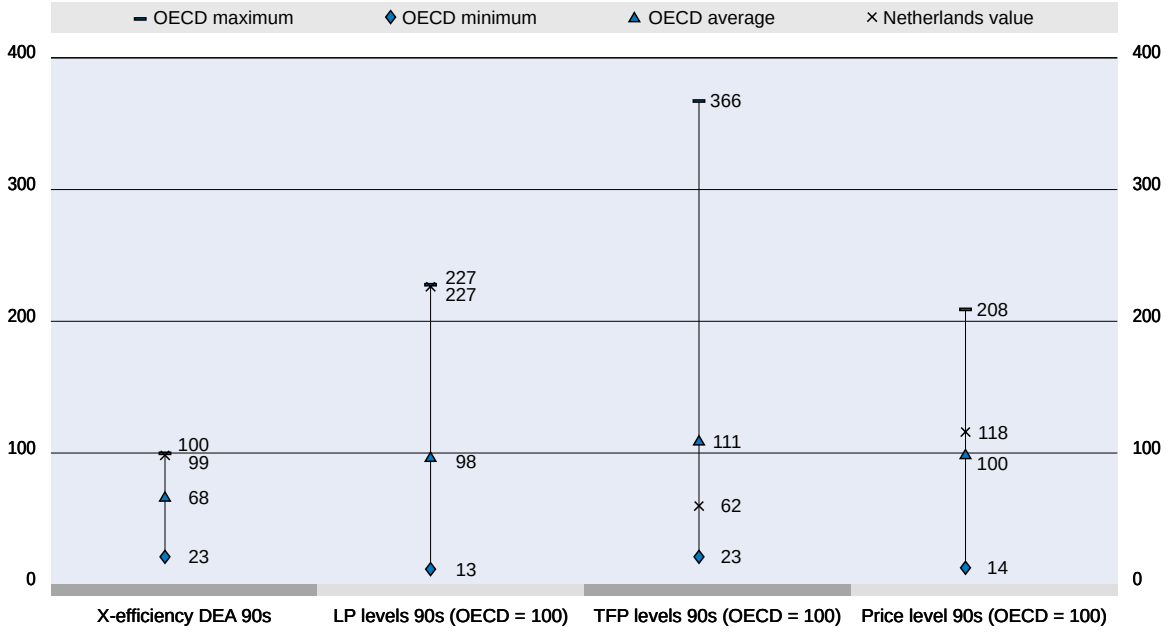



Figure 1.7*b*. **Netherlands performance in levels in rail transport *vs.* OECD countries**




*Notes:* For each figure the vertical line covers the range of all values from the maximum to the minimum of the relevant group of countries.
Output = passengers-km.
Employment = total employment.
Labour productivity (LP) = passengers-km/employment.
Total factor productivity (TFP) = passengers-km as output, employment as number of locomotives as inputs (the labour share is set to 0.6, which is the OECD average for transport).
DEA = data envelope analysis with vehicle-km and gross tonnes-km as output and employment, tracks, number of locomotives, number of goods and passengers wagons, and fuel use as inputs.
Price level = PPP for long distance land transport (including coaches).
*Source:* European Conference of Ministries of Transportation (ECMT), United Nations.

Figure 1.8*a*. **Netherlands growth performance in air passenger transport *vs.* OECD countries**

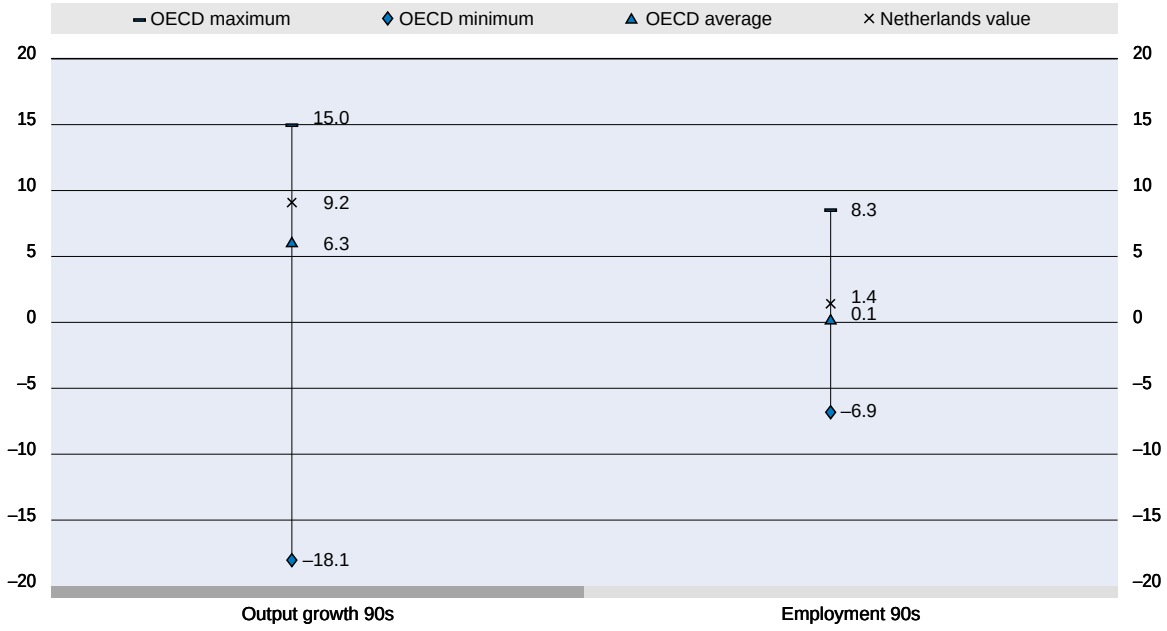
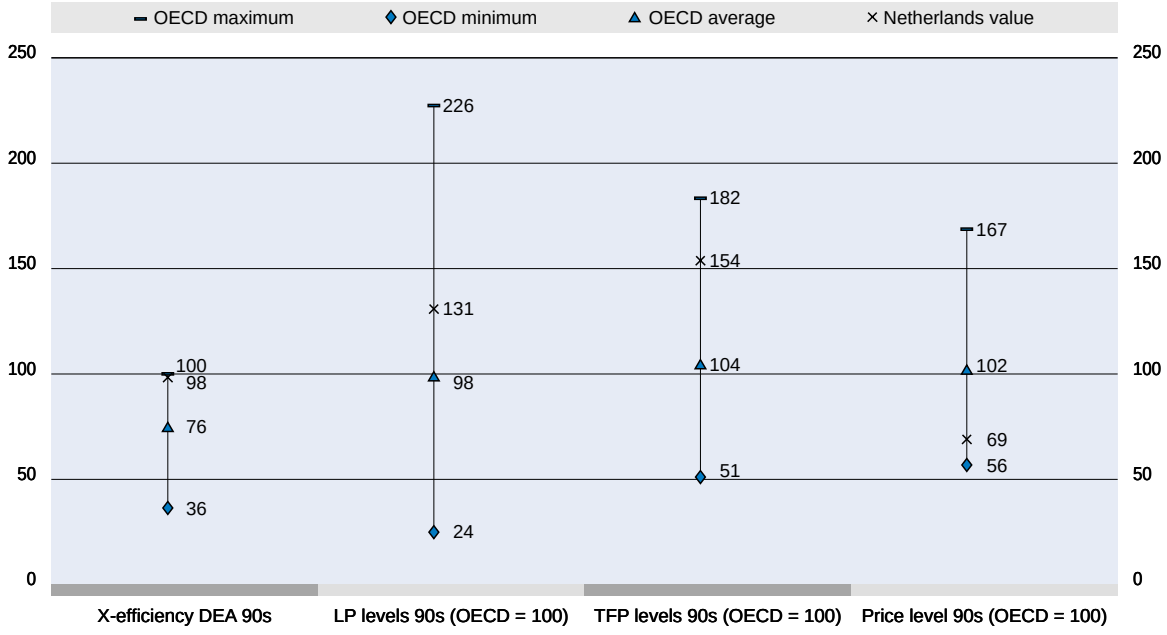



Figure 1.8*b*. **Netherlands performance in levels in air passenger transport *vs.* OECD countries**




*Notes:* For each figure the vertical line covers the range of all values from the maximum to the minimum of the relevant group of countries.
Output = transported passengers-km (TPK).
Employment = total employment.
Labour productivity (LP) = TPK/employment.
Total factor productivity (TFP) = output is TPK and capital is total seating capacity (the labour share is set to 0.6, which is the OECD average for transport).
DEA = data envelope analysis using passengers transported and TPK as output and total personnel, numbers of planes, km flown and total seat capacity as inputs.
Price level = operating revenue per TPK.
*Source:* Institut du transport aérien (ITA) and OECD.

Figure 1.9*a*. **Netherlands growth performance in road freight transport *vs.* OECD countries**

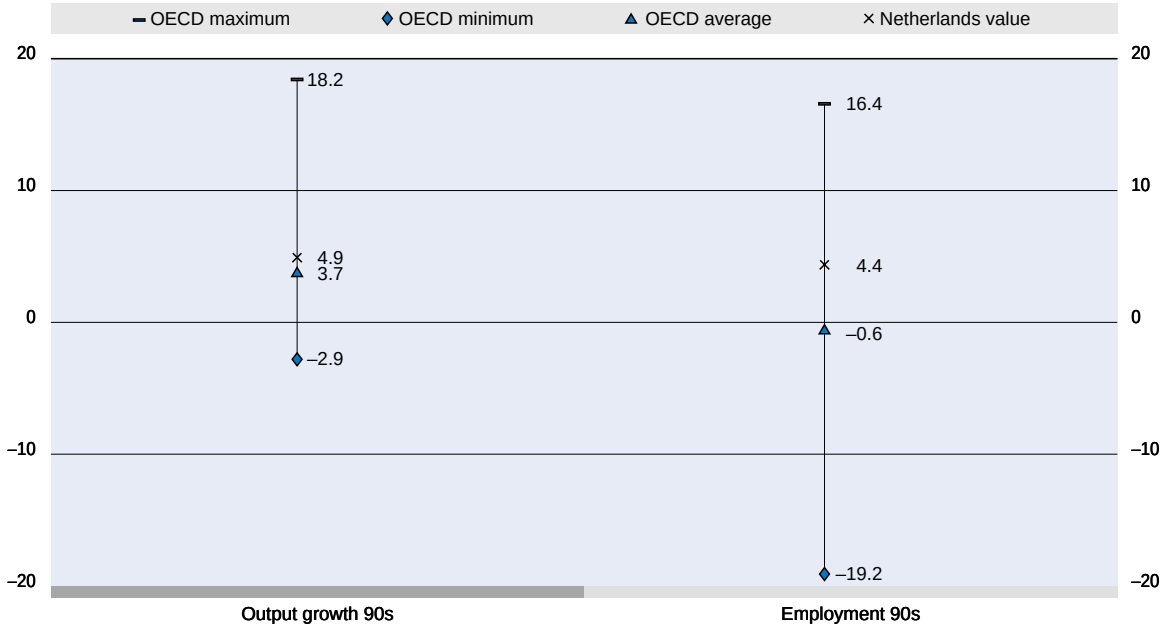
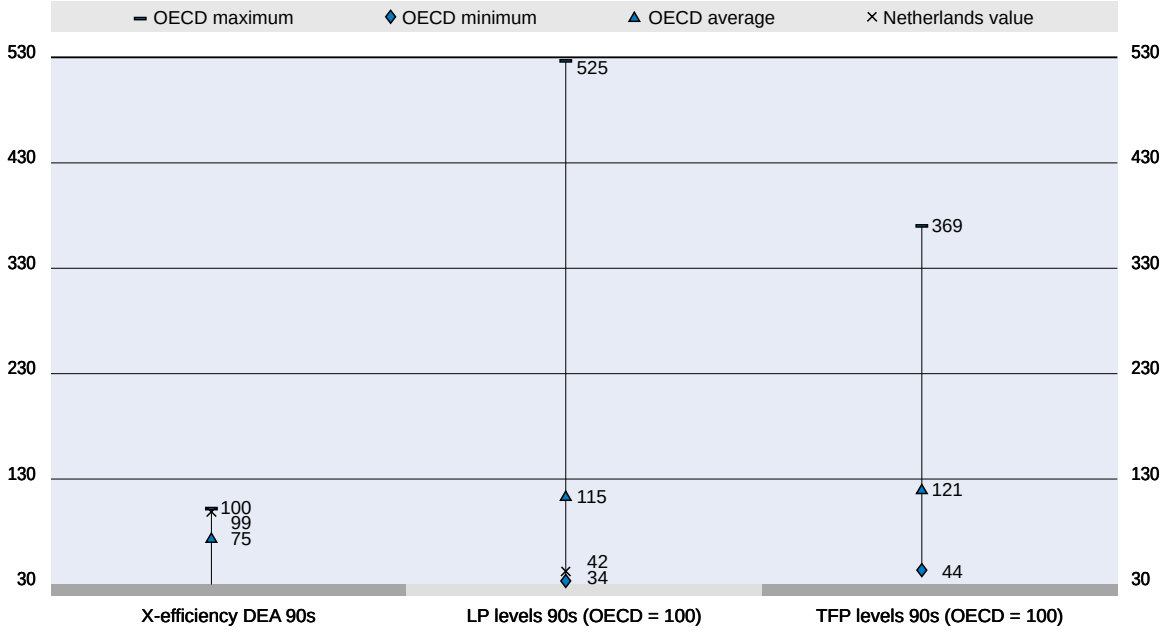



Figure 1.9*b*. **Netherlands performance in levels in road freight transport *vs.* OECD countries**




*Notes:* For each figure the vertical line covers the range of all values from the maximum to the minimum of the relevant group of countries.
Output = tonnes-km.
Employment = total employment.
Labour productivity (LP) = tonnes-km/employment.
Total factor productivity (TFP) = output is tonnes-km and inputs are employment and capital, measured as total tonnes capacity of the fleet (the labour share is set to 0.6, which is the OECD average for transport)).
DEA = data envelope analysis using tonnes transported (domestic and international), tonnes-km, vehicle-km as outputs and employment, small tracks (< 1.5 ton) and large trucks (> 1.5 ton) as inputs.
*Source:* European Conference of Ministries of Transportation (ECMT).

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*Part II*

# BACKGROUND REPORTS

# BACKGROUND REPORT ON GOVERNMENT CAPACITY TO ASSURE HIGH QUALITY REGULATION*

* This report was principally prepared by **Rex Deighton-Smith,** Administrator for Regulatory Management and Reform in the Public Management Service, and **Scott H. Jacobs,** Head of Programme on Regulatory Reform, OECD. It has benefited from extensive comments provided by colleagues throughout the OECD Secretariat, by the Government of the Netherlands, by Member countries as part of the peer review process, and by the Trade Union Advisory Committee and the Business Industry Advisory Committee. This report was peer reviewed in June 1998 in the OECD's Working Party on Regulatory Management and Reform of the Public Management Committee.

# TABLE OF CONTENTS

## Executive Summary

## Background Report on Government Capacity to Assure High Quality Regulation

Can the national administration ensure that social and economic regulations are based on core principles of good regulation? Regulatory reform requires clear policies and the administrative machinery to carry them out, backed up by concrete political support. Good regulatory practices must be built into the administration itself if the public sector is to use regulation to carry out public policies efficiently and effectively. Such practices include administrative capacities to judge when and how to regulate in a highly complex world, transparency, flexibility, policy co-ordination, understanding of markets, and responsiveness to changing conditions.

Initiatives to improve the quality of national regulation have been underway in the Netherlands for 15 years. They have developed and broadened in scope to include legal and economic standards for good regulation. Especially since 1994, regulatory reform has been fundamental to policies to improve economic performance and to stimulate entrepreneurial energies. Its aim has been to achieve a "new balance between protection and dynamism". Partly under the pressures of the European Single Market, a long-term shift is underway from corporatist to market decision-making, and from pro-producer to pro-consumer regulation. This shift demands profound changes to the processes and culture of policy-making in the public sector.

Good results are seen in some areas in reducing unnecessary regulatory barriers to economic activity and in improving policy cost-effectiveness. Administrative reforms have improved the capacity of the public sector to decide when and how to regulate in a more market-driven economy. Use of innovative policy instruments that produce better policy results at lower cost is among the most advanced in OECD countries. Reform in a few important areas – extension of shop hours, reductions in some permits and licenses, and removal of some monopoly rights for lawyers – have been accomplished. Significant savings may have been achieved by reducing administrative burdens. The public debate is intensive and well-informed, and public fears about potential negative effects of reform on consumer protections and equity are abating, though the sustainability of reform will depend on public perceptions about its effects.

Yet while these steps were necessary, they are not sufficient to have more than a marginal effect on economic performance. The scope of reform should be expanded, and its pace greatly accelerated. Concerns about the complexity and rigidity of the national regulatory system continue to be voiced. Reform has barely touched many areas where consumer choice is restricted, where burdensome requirements discourage market activity, and where innovative instruments can improve performance. Improvements to regulatory responsiveness, transparency, and accountability are needed. Lengthy legislative processes have delayed reform proposals, eroding the benefits of reform, and raising serious concerns about future policy responsiveness in the Netherlands. Regulatory impact analysis will continue to disappoint without improvements to analytical rigour. Finally, regulatory quality reforms made at the national level should be co-ordinated at European and subnational levels to ensure that gains are preserved and extended throughout the regulatory system.

# 1. THE INSTITUTIONAL FRAMEWORK FOR REGULATORY REFORM IN THE NETHERLANDS

## 1.1. The administrative and legal environment in the Netherlands

The Netherlands' political culture has been described as having strong corporatist elements, and indeed the typical patterns of corporatist interest representation can readily be seen: comprehensive organisation, stability, orientation toward common interests, and a consensual or problem-solving style of decision-making.[1] The Dutch organisation of economic and social policy-making has been based during most of this century around institutions that incorporate through formal procedures the interests of organised capital and labour. These relationships go far beyond "consultation". An administrative characteristic of importance to regulation is that the state has often shared sovereignty over making and applying public policy with these organised market interests.

The concrete aspects of Dutch corporatism can be seen at political and administrative levels. Governments in the Netherlands are generally formed of coalitions of several political parties. A key advisory body, the Social and Economic Council, is structured to be representative of a range of organised interests in society. A large number of industry and professionally based consultative bodies have grown up over decades. Many of these organisations have been delegated various regulatory functions. This complex of private organisations forms the framework for a pervasive set of cartel arrangements (the background report on The role of competition policy in regulatory reform discusses the Dutch "cartel paradise").

This institutional structure allows organised interests in the market much influence in the making and applying of policy. They have extensive opportunities to be heard, and they thus profit from a political culture that is disposed toward compromise to secure consensus. Many analysts have praised the Dutch model for its capacity for flexible adjustment to changing external conditions.[2] The Dutch approach has also resulted historically in a high level of compliance with legislation, apparently due to a sense of shared "ownership" or responsibility. It has produced what is widely seen in the Netherlands as a high level of protection for consumers with respect to quality, and its distributional aspects have

Box 1. **Good practices for improving the capacities of national administrations to assure high-quality regulation**

The *OECD Report on Regulatory Reform*, which was welcomed by Ministers in May 1997, includes a co-ordinated set of strategies for improving regulatory quality, many of which were based on the 1995 Recommendation of the OECD Council on Improving the Quality of Government Regulation. These form the basis of the analysis undertaken in this report, and are reproduced below:

**A. BUILDING A REGULATORY MANAGEMENT SYSTEM**

1. Adopt regulatory reform policy at the highest political levels
2. Establish explicit standards for regulatory quality and principles of regulatory decision-making
3. Build regulatory management capacities

**B. IMPROVING THE QUALITY OF NEW REGULATIONS**

1. Regulatory Impact Analysis
2. Systematic public consultation procedures with affected interests
3. Using alternatives to regulation
4. Improving regulatory co-ordination

**C. UPGRADING THE QUALITY OF EXISTING REGULATIONS**

(In addition to the strategies listed above)

1. Reviewing and updating existing regulations
2. Reducing red tape and government formalities

mediated equity concerns. These arrangements are also said to give government better access to information, improving the basis for policy-making, while use of professional bodies as regulators may offer significant benefits in terms of cost savings and expertise.

However, a number of factors – notably the "Dutch disease" of low labour force participation and unsustainable welfare policies that led to crisis in the early 1980s and the increased integration of the Dutch economy into Europe through the Single Market – have provoked re-examination of many aspects of this corporatist system. The corporatist, cartel-oriented structures underlying much Dutch economic organisation came into conflict with the direction of European legislative change, particularly after the adoption of the Single Market programme. Social changes within Dutch society, such as the emergence of consumer and environmental concerns, also led to questioning of the legitimacy of the tripartite arrangements underpinning many consultative structures. As the society became more pluralist, systems that favoured a limited range of interests became less legitimate.

Regulatory reform in the Netherlands had its genesis in this profound (and continuing) re-examination of the corporatist organisation of Dutch society. Among the earliest re-assessments along this line was the work of the Commission on Deregulation of Governmental Regulations (Commissie Geelhoed), which presented its final report in 1984. It concluded that characteristics of the Dutch institutional structure bore major responsibility for an excessively complex, heavy, and far reaching legislative structure. It found that when the Cabinet and individual Ministers made commitments during budget talks and other parliamentary discussions about the content of future regulation, they did not consider the practicality, coherence, and legal feasibility of those commitments. The Commission found that extensive processes of interministerial co-ordination and Parliamentary scrutiny often greatly increased the detail and complexity of legislation. It concluded that, although this process of constant consensus seeking can ultimately lead to results satisfactory for the parties involved, it can also be inefficient, ineffective or even impossible to implement.[3]

The report of the Commissie Geelhoed was one of many sources questioning the regulatory effects of the Dutch administrative and legal system. Extensive reforms in the areas of social, labour, and competition policies in the late 1980s and in the 1990s have reduced to some extent the participation of organised market interests in policy-making and implementation, improved transparency and accountability in the administrative system, and transferred more economic decisions to the market. Yet extensive aspects of the corporatist system have been maintained, amid continuing discussion about both its positive and negative aspects. The benefits of a participatory and largely consensual system of policy formation remain highly regarded in Dutch society. Indeed, some of the changes made have sought to better serve the values of participation in the context of a more pluralist and less organised society. Dutch policy makers have argued that the Government's determination to make changes to the system has forced a re-examination of their roles by the representative organisations, with positive reinventions frequently being the result. "The Dutch case of negotiated social policy reform proves that modernization of the European welfare state is possible after all", concluded a recent assessment of reforms to the Dutch state.[4] The direction, scope, and potential of regulatory reform will continue to be defined by the evolution of the relations between the Dutch State, market, and society.

### 1.2. Recent regulatory reform initiatives to improve public administration capacities

Regulatory reform began in the Netherlands in the mid-1980s, and has passed through several stages, supported by a developing consensus that more and deeper reform was needed. The current regulatory reform programme was established by the previous Government after it came to power in 1994. Regulatory reform was given a prominent position in the coalition agreement (the policy basis on which the government is founded). Following the May 1998 elections, the issue of regulatory reform was again prominent in the negotiation of the new Government's coalition agreement and the programme pursued since 1994 is to be continued and further refined.

The objective of the programme is, according to the coalition agreement, to achieve a "*new balance between protection and dynamism*".[5] Competition and regulatory quality are to be strengthened through three strategies: adoption of a new competition law; increased exposure of the public sector to market forces; and a multi-faceted programme on the "Functioning of Markets, Deregulation and Legislative Quality" (MDW). MDW aims to improve the functioning of markets by strengthening competition through regulatory reform; by abolishing or streamlining regulations to "return to what is strictly necessary"; and by better *ex ante* analysis of likely effects to improve the quality of new regulations, both laws and lower-level regulations. The MDW programme is the main vehicle for improving regulatory quality, and as such is the centrepiece of Dutch regulatory reform policy.

MDW is part of wider policy changes indicating a new relationship between State and market. The key initiative affecting competition was the adoption of an entirely new competition law, which took effect in January 1998 (see the background report on The Role of Competition Policy in Regulatory Reform). A principal purpose of this law is to make Netherlands competition policy consistent with EU directives on competition. However, changing views on competition in the Netherlands may have led to significant reform even without that incentive. Such changes made possible current efforts to introduce and/or strengthen competition as a means of improving efficiency and service quality in a range of government provided or government funded activities including health, education and social security. Changes to consultation processes over the last several years, which have de-emphasised consensus seeking and co-operative (and frequently collusive) structural elements, also suggest changing attitudes about market forces.

The current programme builds on a decade of earlier efforts. Reform began in the Netherlands as a question of legislative quality, seen in its widest sense of accountability, feasibility, effectiveness, and legitimacy. Concerns about economic impacts, business costs, and market incentives emerged in an important way only in the 1994 programme. As a result, regulatory reform was long seen as being of particular interest to legal experts. The primary role in reform has traditionally rested with the Ministry of Justice, which played a pioneering role in getting regulatory reform onto the political agenda.

### Box 2. Activities under the MDW programme

*Special subjects*

Each year, about ten in-depth reviews of specific areas of legislation are proposed by the Civil Service Commission following consultations with interested parties and are approved by the Ministerial Commission. Working groups conduct the reviews and recommend reforms. **See Section 4.**

*Critical assessment of draft legislation*

Regulatory impact assessment has been required in the Netherlands since 1985. A significant overhaul of the programme was implemented under the MDW programme. RIA is today broad ranging, covering a proposal's impacts on business and the environment, as well as assessing its feasibility and enforceability. **See Section 3.3.**

*Reducing administrative burdens*

A programme to reduce administrative burdens has been part of MDW since 1994. In 1993, it was estimated that aggregate costs of administrative burdens was 13 billion Dfl. A target of reducing costs by 10 per cent, or 1.3 billion Dfl, was set. This was judged to have been met in 1998 and a new target of a further 25 per cent reduction is being considered for the second stage of the programme. The programme contains a number of elements including reviews by administering agencies, consultations with a panel of entrepreneurs and technology based projects. **See Section 4*b*.**

### Box 3. MDW 2

Following the May 1998 elections, on 12 October 1998, the Ministers for Justice and Economic Affairs sent a letter to Parliament informing it of the future shape decided for the MDW programme. The programme will continue along broadly the same lines as pursued since 1994. However, three changes should be highlighted:

*Selection of "special subjects"*

The process of selecting subjects for review is to be made more open to outside input through the implementation of a new "orientation phase" of several months at the commencement of the "MDW 2" programme, during which business and public input will be sought through conferences, round table meetings, and talks with public organisations.

*Faster implementation*

The need for faster implementation of reforms (discussed in the recommendations below) has been acknowledged. Process changes are not proposed, but it is hoped that the greater involvement of business and the public in setting the MDW2 agenda will lead to a faster process as its supporters become more vocal in its support and it is "not only pushed, but also pulled".

*Greater transparency in the "advisory phase"*

Process changes are, again, not proposed in response to criticism that interested parties are not sufficiently closely involved in the design of specific MDW reforms. Instead, Cabinet has taken the view that this objection can be largely eliminated by "making what happens in the overall MDW process more visible to the outside world".

### Box 4. Milestones in Dutch regulatory reform

**1984** Final report of Commission on Deregulation of Government Regulations (Commissie Geelhoed) argues that the corporatist elements of the Dutch administrative and legal system bear major responsibility for an excessively complex, onerous and far reaching legislative structure.

**1984** Revised Directives on Legislation issued by Prime Minister. They are expanded to include a wider range of legislative quality issues not related to technical law-drafting issues.

**1985** Grapperhaus Commission assessed administrative compliance costs and proposed reforms. Requirement for Regulatory Impact Assessment introduced.

**1985** Council of State identifies major regulatory quality issues at the request of Ministry of Justice. Highlights legislative/policymaking relationships, interministerial co-ordination and recruitment and development of law-drafting experts.

**1987** Commission on Assessing New Legislative Projects (CTW) introduced.

**1989** Ministry of Justice given explicit responsibility for legislative policy and the General Legislative Policy Division was created.

**1991** Minister of Justice issues legislative policies guidance paper "Legislation in Perspective" with Cabinet authority.

**1992** Revised Directives on Legislation drafted by Ministry of Justice and issued by Prime Minister.

**1993** General Accounting Office completes review of regulatory processes, concluding that most of the problems identified by the Council of State in 1985 were still unsolved.

**1994** MDW programme incorporated into the programme of the newly elected government. Includes a mechanism for reviewing existing legislation, overhaul of RIA requirements and an administrative burden reduction programme.
Van Lunteren Commission examines taxation on SMEs and new enterprises.

**1998** New Competition Act comes into force. New coalition agreement establishes "MDW 2".

Several commissions were established by governments from the early 1980s to consider broad reform issues. The mandates of these committees were oriented to technical legal issues and they were primarily constituted from legal experts. The policy changes that followed from their work, as well as from reform thinking within the administration, have covered a range of fields.

The first of the commissions appointed was the Commissie Geelhoed, mentioned above. It concluded that there was too much regulation and that it was excessively complicated, and made a key contribution through its analysis of the institutional reasons for these problems. Another important commission, established under the auspices of the Ministry of Justice, was the Commission for the Assessment of Legislative Projects, which operated between 1987 and 1993 and conducted 55 assessments that concluded in recommendations for reform. Although substantive reforms were achieved in about half of these cases, it attracted relatively little political attention and support. Its approach was legalistic, and it did not base its findings on the economic impacts of regulations. It was replaced by the more economically-focused MDW programme in 1994.

An Interdepartmental Commission on the Harmonization of Legislation (ICHW) was also established in this period and continues to operate. In 1985, the Minister of Justice sought the involvement of the Council of State in reform efforts by inviting its comments on the most pressing regulatory quality issues. The Council identified problems in the relationships between legislative and policy functions within the administration, inadequate inter-ministerial co-ordination, and the need to focus on the recruitment and development of law-drafting experts. In 1992, revised Directives on Legislation, prepared by the Ministry, were formally issued by the Prime Minister. They focused on the need for reform, set out quality criteria for legislation and stressed the use of alternative policy instruments and alternative legal structures.

The General Accounting Office was also involved in reviewing the functioning of the regulatory process, and in assessing the progress made by earlier reform efforts between 1991 and 1993. It concluded that, of the issues raised by the Council of State in 1985, only in the area of harmonization of legislative activities had progress been made. Moreover, it was unable to conclude whether the 1990 quality criteria for legislation were actually being used by ministries, as only rarely was the use of the criteria documented. Its findings were important in showing the need for a stronger programme such as the MDW.

## 2. DRIVERS OF REGULATORY REFORM: NATIONAL POLICIES AND INSTITUTIONS

### 2.1. Regulatory reform policies and core principles

The 1997 *OECD Report on Regulatory Reform* recommends that countries "adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation".[6] The *1995 OECD Council Recommendation on Improving the Quality of Government Regulation* contain a set of best practice principles against which reform policies can be measured.[7] The content of, and political commitment for, Dutch regulatory reform policies demonstrates a generally high level of consistency with these recommendations.

Since the 1980s, explicit national policies on regulatory quality and regulatory reform have been adopted in the Netherlands, and have steadily expanded in scope and ambition. The direction of policy evolution has been from legal concepts of regulatory quality (technical law-drafting quality, codification), toward development of procedural and empirical standards (use of regulatory impact analysis, directives setting out explicit technical, legal and process guidance on regulation making) and recently to strategies aimed at changing long-held administrative habits and incentives (review mechanisms, transparency, use of alternatives, targeted reform of existing regulations), backed up by reform drivers inside the administration. Over time, more care has been demanded of ministries in their use of regulatory powers.

The current reform policy establishes clear political accountability. A Ministerial Committee chaired by the Prime Minister directs the reform process. Other standing members include the Ministers of Justice and of Economic Affairs (also responsible for competition policy), who are considered the "co-ordinating Ministers" for the MDW programme. All Cabinet Ministers have a standing

invitation to attend the Commission and, in practice, other Ministers often participate. At the political level, then, the MDW programme is managed by a body with the authority, accountability, and cross-cutting vision to provide strong impetus for reform.

Strategic objectives have been set for the reform programme that should help give general direction to efforts in the ministries. The programme aims to increase economic performance and "dynamism, and to ensure that the benefits are reaped by consumers, through prices, choice, and high levels of protection. Reform also aims to improve policy effectiveness. However, except for quantitative targets for administrative burden reductions, the programme lacks results-oriented goals that would serve to "operationalise" these strategic objectives and allow ministries to be held more accountable for performance. The OECD Report also recommends that governments "ensure that reform goals and strategies are articulated clearly to the public". Engaging the public in a dialogue on the aims, benefits, and costs of regulatory reform has received, and will continue to need, attention in the Netherlands, given opposition from entrenched market interests, and others anxious that a "24-hour economy" will reduce the quality of life.

Consistent with OECD recommendation that "governments establish principles of 'good regulation' to guide reform", explicit standards for regulatory quality have been adopted, as have principles of regulatory decision-making. The Dutch principles cover both economic and legal quality concepts. The primary reference for quality standards is the "Directives on Legislation" developed by the Ministry of Justice since 1972. These are a set of binding rules for all Ministries involved in preparing and drafting legislation (both primary and subordinate) and are formally issued by the Prime Minister. Structured as a set of instructions with explanatory/advisory material, they constitute explicit criteria for making decisions as to whether and how to regulate. Key standards are:

– The need for regulation should be justified (*i.e.*, by applying a "threshold test" regarding the size of the problem and the appropriateness of regulation as a solution).
– Objectives of regulation should be clearly defined.
– The regulation should be clear.
– The most cost-effective regulatory or non-regulatory alternative should be chosen.
– Indirect effects, including competitiveness, investment climate, etc., should be considered.
– The regulation must be enforceable.

The content of these quality standards is comprehensive and well-conceived, and compares favourably to regulatory quality standards in place across the OECD area. The Dutch directives have, in fact, been used by some non-OECD countries as a model in developing regulatory quality systems. However, the Ministry of Justice's recent review of the use of these directives found that they have had limited effectiveness in practice. This may be due to inadequate quality control over their use. An interdepartmental working group is currently "reviewing the possibilities for increasing the familiarity, practicability and consequently the application of these tests". And it is expected that the general principles will be translated into specific rules, so that they can be fitted to specific subject areas.[8]

A notable gap should be identified. The OECD has recommended as a key principle that regulations should "produce benefits that justify costs, considering the distribution of effects across society." This principle is referred to in various countries as the "proportionality" principle or, in a more rigorous and quantitative form, as the benefit-cost test. Such a test is the preferred method for considering regulatory impacts because it aims to produce public policy that meets the criterion of being "socially optimal" (*i.e.*, maximising welfare).[9] This key principle is insufficiently developed in the Netherlands, although an early result of this review has been the establishment of an inquiry into the possibility of adopting an explicit and quantitative benefit-cost test to be performed when discussing draft legislation.[10]

The Directives on Legislation require consideration of proportionality during the development and drafting of legislation, and there is a degree of external verification (through the Ministry of Justice review of draft legislation prior to submission to the Council of Ministers). Moreover, proportionality is a guiding principle of the European Union in its legislative activities, and so is considered in the development of that part of Dutch legislation originating at EU level. However, the Dutch framework for

regulatory impact assessment includes neither consideration of proportionality nor a benefit-cost test. Thus, there is no mechanism by which ministries document their application of the proportionality test, no public testing of these conclusions, and no opportunity for challenge.

### 2.2. Mechanisms to promote regulatory reform within the public administration

Reform mechanisms with explicit responsibilities and authorities for managing and tracking reform inside the administration are needed to keep reform on schedule, and to avoid a recurrence of over-regulation. As in all OECD countries, the Netherlands emphasises the responsibility of individual Ministers for matters within their portfolios. Each Minister is formally seen as having a significant responsibility for the implementation of regulatory reform policy.

But it is often difficult for ministries to reform themselves, given countervailing pressures, and maintaining consistency and systematic approaches across the entire administration is necessary if reform is to be broad-based. Hence, the Netherlands has established a series of centralised oversight bodies for regulatory reform. In fact, the administrative drivers by which MDW is administered and legislative quality is promoted are among the most developed in OECD countries. The large number of bodies within the administration with specific responsibility for elements of regulatory management and reform may constitute an important strength of the Dutch system, as reform is carried out across a broad front and has numerous supporters or "champions". At the same time, this complexity throws the question of co-ordination between reform bodies into sharp relief. This issue is considered in Section 5.3., below.

The MDW programme is managed by a highly formalised set of structures. In addition to the Ministerial Committee chaired by the Prime Minister (described above), defined implementation responsibilities are allocated to the Ministries of Justice and Economic Affairs. The two ministries work with a high level and independent (that is, not contained in any ministry) Civil Service Commission with two key functions: 1) it identifies priority areas for reform under the "special topics" element of MDW and prepares proposals for consideration by the Ministerial Commission; and 2) it appoints *ad hoc* working groups to prepare specific proposals. Allocating these responsibilities to an independent commission reinforces the advantages of a Cabinet committee in that reform is again conceived as a government wide and cross-cutting responsibility, rather than of interest only to single departments and carried out by sectional interests. Moreover, it improves capacity to provide strong central direction for the overall performance of the reform programme.

The working groups appointed by the Civil Service Commission have civil service members but may also include experts from the private sector, academia, or local or provincial governments. Notably, private sector appointees do not have full access to the deliberations of the working groups. Chairs of working groups are generally civil servants, but, in order to enhance the independence of reviews, they are not appointed from the department with major responsibility for the area under review.

This interministerial structure also means that review topics do not need to be restricted by policy demarcations between individual ministries, which should allow for more "thematic" and cross-cutting reviews and yield more integrated recommendations for reform.

Day to day responsibility for MDW falls to the Ministries of Economic Affairs and Justice, each of which runs a support desk providing services such as guidance and assistance on the scrutiny of regulatory proposals. The Ministry of Environment also provides assistance to agencies in answering the environmental aspects of the RIA question framework. Thus, regulatory quality control is able to draw on economic, legal and environmental expertise provided in a co-ordinated way.

The Ministry of Justice has other key management roles for legislative quality assurance. In 1989, the Ministry of Justice was given exclusive responsibility for legislative quality policies, and in 1990 the General Legislative Policy Division was established for this purpose. In addition to producing the Directives on Legislation, the division reviews, assesses and negotiates with ministries all draft laws prior to submission to the Cabinet. While the division cannot stop bills that it finds to be unsatisfactory, it can advise the

Cabinet of its opinion. This mechanism has sometimes resulted in the return of draft bills by the Cabinet to ministries for further consultation with the Ministry of Justice. In addition, the Inspectorate of Law Assessment has responsibilities for legislative enforcement and enforceability. It acts as an internal consultancy for Ministries and develops extensive guidance materials to assist them to improve compliance rates.

An important new mechanism to promote legislative quality – a programme of rolling audits of the legislation making processes of all Ministries – has been launched. The Minister of Justice has appointed an independent review committee (three academics, three Ministry staff and three members from "government/society at large"). Their review is based on self-assessment supplemented by an external review by independent experts. The self-assessment involves a review of each ministry's performance against criteria such as:

– The quality of the legislative process – including the relationship between legislative, policy-making and executive units, and the interministerial, political and international context in which the work is done.

– The quality of staff involved in preparing legislation, *i.e.*, the professionalism of the organisation with regard to the task of preparing legislation.

– The quality of the organisation, including the way the work is organised.

Once Ministries have completed self-assessments, they will be visited by a review team, who will provide a report and recommendations to the responsible Minister. This process should take around 18 months, with follow up reviews conducted on one third of Ministries every two years subsequently. In addition, a report detailing overall progress will be made to Parliament every two years. This review process conforms closely to best practices regarding the need to balance Ministerial responsibility for conducting analysis with quality assurance through independent assessment. It provides a high level of transparency, through parliamentary reporting, and has a dynamic focus, with reviews to be repeated at regular intervals. This new mechanism has the potential to contribute significantly to legislative quality.

### 2.3. Co-ordination between levels of government

The 1997 OECD Report advises governments to "encourage reform at all levels of government". This difficult task is increasingly important as regulatory responsibilities are shared among many levels of government, including supranational, international, national, and subnational levels. High quality regulation at one level can be undermined or reversed by poor regulatory policies and practices at other levels, while, conversely, co-ordination can vastly expand the benefits of reform. The Netherlands is a unitary country, yet co-ordinating reforms with both local and supranational levels of government would enhance its reform efforts.

At subnational levels, the Netherlands has 12 provincial governments and 560 municipal governments. The regulatory powers of these governments are quite limited (although it is possible for them to make supplementary regulations in areas that have already been regulated at the national level), but they have important implementation and enforcement functions, particularly in physical and environmental planning.

A significant legislative change to enhance regulatory co-ordination with sub-national governments took effect in January 1994. It requires that subnational governments be consulted whenever proposed regulations would charge them with carrying out specific tasks. This consultation is generally conducted through their representative associations. At the same time, there are moves to delegate more regulatory authorities to sub-national governments. For example, the most recent National Environmental Policy Plan[11] states that changes will be made in environmental regulations "to increase the autonomy of regional and local authorities…". Such moves place higher priority on improving the regulatory decisions of subnational authorities in line with national quality standards.

Of considerable importance is co-ordination of regulatory reform initiatives with the institutions of the European Union. A significant part of Dutch legislation and other regulation has its origins in European directives and regulations, and a 1995 study found that "to an increasing degree, regulations with business impacts find their roots in European mandatory legislation".[12] The important role of European legislation

adds complexity to Dutch reform efforts and has likely had both positive and negative effects. It is probable that in important areas such as competition law, the presence of strong European level requirements have strengthened the hand of reformers within the Netherlands (see background report on The role of competition policy in regulatory reform, for further discussion). On the other hand, Dutch policy makers have expressed frustration with aspects of the European regulatory structure, arguing *inter alia* that it has tended to inhibit their efforts to adopt alternatives to traditional regulation in some areas. Concerns over technical quality issues lead the Netherlands to focus on legislative quality as a major topic of its 1997 Presidency of the EU. This led to an intensified programme of work within the European Commission to improve the quality of European legislation and. has been followed-up by the subsequent British and Austrian Presidencies in 1998. Dutch officials have indicated that a future priority is to improve the flow of information to Brussels on regulatory assessment issues so as to provide timely and useful inputs to assessment efforts within the European Commission.

Box 5. **European law in EU Member countries**

European legislation is implemented via two major instruments: Regulation and Directives. Regulation is required to be adopted in whole and without amendment by Member countries and is used where complete regulatory uniformity is considered necessary to achieve the legislative requirement. Directives are considerably more flexible. They consist of "Common Essential Requirements" which must be incorporated into legislation by Member countries. However, the form in which they are incorporated is left to the Parliaments of those countries to determine. The EU operates according to the principle of subsidiarity, which states that decision should be taken as close as possible to the citizens of the Union. Thus, the use of Directives is favoured as a general rule, with regulation being used only where Directives are seen as unable to achieve the object of the legislation.

From 1992, a significant programme of European legislation has been undertaken in order to implement the commitment to achieving the Single Market. The Single Market is based on the idea of the "four freedoms"; that is, that there should be free movement of people, capital, goods and services between Member states. This programme of legislation is now largely complete, which has meant that the annual number of legislative proposals from the European Commission has been falling in recent years.

## 3. ADMINISTRATIVE CAPACITIES FOR MAKING NEW REGULATION OF HIGH QUALITY

### 3.1. Administrative transparency and predictability

Transparency of the regulatory system is essential to establishing a stable and accessible regulatory environment that promotes competition, trade, and investment, and helps ensure against undue influence by special interests. Just as important is the role of transparency in reinforcing the legitimacy and fairness of regulatory processes. Transparency is a multi-faceted concept that is not easy to change in practice. It involves a wide range of practices, including standardised processes for making and changing regulations; consultation with interested parties; plain language in drafting; publication, codification, and other ways of making rules easy to find and understand; and implementation and appeals processes that are predictable and consistent. The Dutch regulatory system has made much progress in these areas, but some problems merit further attention.

#### *Transparency of procedures: administrative procedure laws*

Dutch legislation sets out specific requirements for administrative procedures to be followed in promulgating both legislation and subordinate regulation, and hence meets the OECD benchmark in this area. The 1983 Constitution enjoined the legislative authorities to promulgate general rules of administrative law. As a result, a process of codification of the existing administrative law has been

undertaken and in January 1994 the General Administrative Law Act came into effect, considerably enhancing the transparency of administrative rights. The Act sets out in detail the procedures to be followed in making administrative orders as well as in objecting to orders and appealing against their application.

***Transparency for affected groups: use of public consultation***

Dutch values of consensus are reflected in national consultation practices. Consultation in the Netherlands is extensive, multi-faceted and strongly institutionalised. It has undergone rapid change in recent years in response to dissatisfaction with its inefficiencies, to improve safeguards against excessive influence by interest groups, and to reflect broader trends toward a more pluralistic Dutch society. Reform of consultation is likely to be a continuing process, and further areas for reform are identified below.

A central principle in Dutch consultation is that of "separation of advice and consultation". This principle reflects two underlying objectives: the search for expert advice to improve regulatory quality and the search for consensus as a political value. Its adoption has resulted in the existence of two formal and distinct consultation structures.

The first of these, constituting the "advisory" function, is composed of a wide range of formal advisory bodies, created in an *ad hoc* fashion by individual legislation to work closely with ministries on policy issues of strategic importance. Membership is notionally based solely on expertise, although in practice direct interests are also represented (for example, the consumer credit advisory body includes consumer and banking associations). The Dutch constitution explicitly authorises and recognises these bodies as "permanent advisory bodies for matters of legislation and administration of the State". The most important advisory body is the Council of State which until recently was required to be consulted on all draft legislation, Orders in Council, and international agreements requiring parliamentary approval. Members are former politicians, judges, scholars, and civil servants and have permanent appointments (until age 70).

The second structure, representing the "consultation" function is composed of the network of advisory bodies created under the Industrial Organisation Act of 1950. Here, the *tripartite principle* is the underlying factor determining representation. The chief consultative body under the Act is the Social and Economic Council (SER), composed of 15 members representing employers' interest, 15 representing employees and 15 independent experts appointed by the Crown on the advice of the government. The industrial advisory bodies also wield considerable regulatory power for their members in areas such as registration, production, sales, wages, training, and enforcement.

These bodies have historically been used within the corporatist system to introduce checks and balances into decision-making, to increase the legitimacy of legislation, to identify "acceptable" policies, and improve the level of "voluntary" compliance, including a smooth and rapid implementation of new legislation, once agreed. Such consultation also ensures that affected parties are well-informed of new regulation in advance and are able to minimise adjustment costs through forward planning. This seems theoretically to be an important consideration, although there is apparently no research to indicate its significance in practice. In recent years, however, these structures have been criticised as unsuited to contemporary economic, social, and administrative realities:

– They have severely dampened policy responsiveness. On average, seven years was required to introduce new legislation, a considerable fraction of which was traditionally spent in consultation.

– The separation of "advice and consultation" has been compromised in practice. Advisory bodies have too often functioned as defenders of narrow self-interests, rather than as providers of expertise.

– As the Commissie Geelhoed found, extensive consultation based on the search for consensus promotes regulatory complexity, as additional details are added in an attempt to balance competing interests.

– By "locking in" consensus solutions at an early stage, the advisory and tripartite bodies have been accused of limiting the role and freedom to act of the Government and Parliament.

– The corporatist and cartel-like structures established under the Industrial Organisation Act are increasingly inconsistent with EU single market policies, particularly competition principles.

– Changes in Dutch society, including a decline in union membership and the rise in other forms of social organisation, meant that the representativeness and hence the legitimacy of the tripartite structures was diminished. The Dutch Government stated in 1993 that *"The desired social base cannot always be obtained by consulting advisory bodies"*.[13]

The Dutch Government has responded with significant reforms. The number of advisory boards was drastically reduced, from 491 in 1976 to 161 in 1991 and 108 in 1993. A yet more radical reform in 1997 abolished all 108 remaining bodies and replaced them with a single advisory body for each Ministry. This reform aims to clearly separate advice and consultation, and to refocus these bodies to major policy issues away from details. The oversight ministries are concerned that too many consultative groups have been re-established following the abolition, but they believe that the change has, nonetheless, improved the situation. Old habits die hard, however, and, without limits on their numbers, there is a continuing danger of proliferation of "new" advisory bodies.

Another fundamental change taken in 1997 is removal of the legal requirement for the government to consult advisory bodies. This follows a more limited change implemented in 1994 (via the General Administrative Law Act) abolishing the consultative requirement in cases where legislation is limited to implementing binding EU legislation. Both of these changes affect the peak consultative bodies (the SER and Council of State). A time limit of three months was also imposed for the provision of advice to reduce the contribution of consultation to the length of the Dutch legislation-making process.

The full effects of these changes cannot yet be estimated. However, recent studies have indicated that the average time taken to implement legislation has been significantly reduced, to about four years.[14] Interestingly, there is some support for the changes from among the major consultative bodies themselves. The SER has stated that it sees significant benefits because the government will request its advice as a matter of choice, rather than by legal necessity. This will permit consultative bodies to focus resources where advice is most likely to be influential.

Despite these changes, ministries are increasingly turning to other consultation approaches that offer still more flexibility and openness. "Informal consultation" is conducted at the discretion of Cabinet, individual Ministers or departments in the absence of any legislative requirement. Since informal consultation is discretionary, the initiator can choose who will participate, and how. Evidence suggests that informal consultations are increasingly being used to do the real work of consensus building, and that formal legislated processes are becoming little more than a subsequent formality. This reflects the fact that informal approaches can be less cumbersome and more flexible and hence better adapted to the need for speed and participation of a wider range of interests.

Another consultation mechanism – the "notice and comment" requirement – is increasingly, though not widely, used. Some laws require pre-publication of regulatory proposals and invitation to comment from all members of the public. This mechanism, like "informal consultation", is more open and non-corporatist than traditional approaches. The Dutch experience with "notice and comment" forms of consultation has not been very successful due to a low level of public participation. One explanation is that the "notice and comment" process is more mechanical and not dialogue-oriented, while Dutch interest groups prefer dialogue. However, it may also be related to the infrequent use of this tool (estimated at less than 10 per cent of regulatory proposals) and its newness. Greater experience may increase its effectiveness, as might attention to better notice of consultation opportunities and provision of better information on policy proposals, particularly by providing regulatory impact assessments as part of the proposal.

*Assessment of consultation reforms.* Together, these reforms represent a major overhaul of virtually all aspects of consultation. By giving the administration greater flexibility on who to consult and when, these reforms have sought to enhance the value-added of consultation in producing hard data and expert opinion, and to streamline the process and reduce delays. Increased use of open "notice and comment" processes aims to increase participation by a greater range of interests. The reforms are consistent with an international trend toward more transparent and accessible regulatory processes.

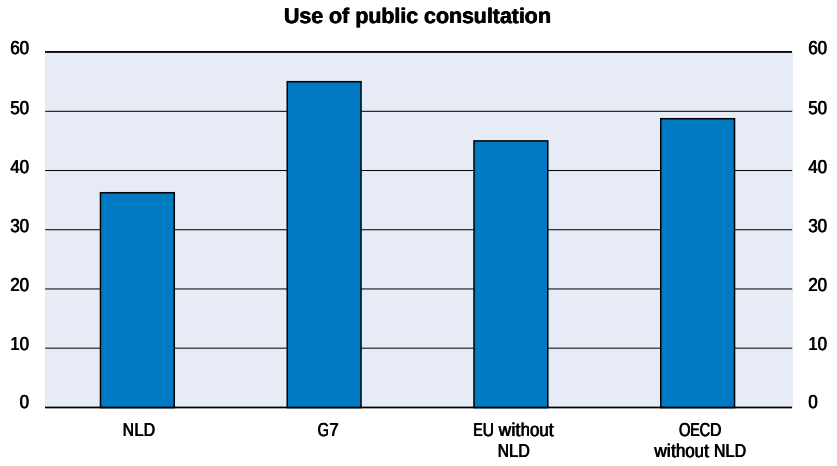
How well have the reforms actually performed? Have they caused additional problems? The answers are as yet largely unknown. Many of the changes made are recent, and as in most OECD countries, there has been no formal evaluation of the performance of consultation in the Netherlands. It is likely that the more flexible, accessible, and targeted approach to consultation will in fact produce important benefits for the quality of regulation, not least because consultation is today occurring within the context of more rigorous controls on regulatory quality. This is seen, for example, in the re-emphasis of the "advice" function over that of "consultation". These changes indicate that consultation is seen today as an input to quality decisions, rather than as an end in itself, which is a major cultural change. One issue that should be closely watched is the tension between flexibility and accessibility. If ministries have too much discretion to pick and choose who will participate, the risk is great that "insider" groups will gain too much access and influence at the expense of "outsiders", and that transparency will be lost. The OECD has recommended that "all interested parties" should have the opportunity to present their views, and this will require systematic and predictable consultation processes of some kind.[15]

***Transparency in implementation of regulation: communication, compliance and enforcement***

The Netherlands is rare among Member countries in specifically addressing issues of compliance and enforcement as part of the process of making legislation and Cabinet regulations. There are three sources of requirements on these issues: the Directives on Legislation of the Ministry of Justice, the Inspectorate of Law Assessment, also within the Ministry of Justice, and the compliance element of the RIA question framework.

Box 6. **Use of public consultation in selected OECD countries**

In this synthetic indicator of the scope and systematic use of public consultation, the Netherlands falls slightly under both the OECD average score and the average for EU Member countries. This indicator looks at several broad aspects of the use of consultation and ranks more highly those that are routine, non-discretionary, accessible to all interested parties, and used earlier in decision processes. Despite the widespread use of public consultation in the Netherlands, its consultation programme is relatively less open to all interested parties, and gives regulators more discretion about when and how to consult, potentially reducing transparency and raising the risk of undue access by special interests.




*Source:* Public Management Service, OECD.

The *Directives on Legislation* require regulators to ensure, before adopting a regulation, that they will be able to "adequately" enforce it. They must explicitly consider whether enforcement under administrative, civil or criminal law would be most appropriate. Explanatory notes to these instructions specify general legislative drafting principles for improving enforceability, including minimising scope for different interpretations, minimising exceptions, directing rules at "situations which are visible or which can be objectively established" and ensuring practicability for both enforcers and the regulated.

In addition to considering administrative, civil or criminal enforcement, drafters are required to determine what role the law on professional misconduct can play and the utility of preventative methods such as information campaigns. The potential benefit of combining enforcement methods should also be considered.

The *Inspectorate of Law Assessment* within the Ministry of Justice acts as consultant to ministries on issues of enforcement and enforceability in relation to legislative proposals. The Inspectorate regards enforceability assessment as essentially probabilistic, recognising that there is inevitably significant uncertainty. It aims to identify the two or three key "risk factors" for compliance/enforcement in relation to each regulatory proposal reviewed to enable policy makers to address these issues in advance.

The review is made as consistent as possible through adoption of standard checklists and other instruments. A key tool is the "table of eleven" key determinants of compliance. These were developed jointly by the Ministry of Justice and Erasmus University and derive from the academic literature in the areas of social psychology, sociology and criminology, supplemented by the Ministry's practical experiences and viewpoints on law enforcement. The table is in three parts:

- *Spontaneous compliance dimensions.* These are factors that affect the incidence of voluntary compliance – that is, compliance which would occur in the absence of enforcement. They include the level of knowledge and understanding of the rules, the benefits and costs of complying, the level of acceptance of the "reasonableness" of the regulations, general attitudes to compliance by the target group and "informal control", and the possibility of non-compliance being sanctioned by non-government actors.
- *Control Dimensions.* This group of factors determines the probability of detection of non-complying behaviour. The probability of detection is directly related to the level of compliance. The factors considered are the probability of third parties revealing non-compliance, the probability of inspection by government officials, the probability of inspection actually uncovering non-compliance and the ability of inspection authorities to target inspections effectively.
- *Sanctions dimensions.* The third group of factors determines the expected value of sanctions for non-compliance, that is, the probability of a sanction being imposed where non-compliance is detected and the severity and type of likely sanctions.

The Table of Eleven is used both to guide reviews of compliance and enforcement relating to existing legislation and as an analytical tool in the development of new regulation. The Table is an innovative and promising approach to the problematic issue of improving compliance. Serious concerns about compliance levels are prevalent in OECD countries as regulatory inflation and the increasing use of complex technical standards put pressure on all three of the compliance factors identified above. The "checklist" approach used in the Netherlands can help regulators consider compliance issues in a detailed, systematic fashion, and also provide a useful review and quality control tool.

### 3.2. Choice of policy instruments: regulation and alternatives

A core administrative capacity for good regulation is the ability to choose the most efficient and effective policy tool, whether regulatory or non-regulatory. The range of policy tools and their uses is expanding as experimentation occurs, learning is diffused, and understanding of the markets increases. At the same time, administrators often face risks in using relatively untried tools, bureaucracies are highly conservative, and there are typically strong disincentives for public servants to be innovative. A clear leading role – supportive of innovation and policy learning – must be taken by reform authorities if alternatives to traditional regulation are to make serious headway into the policy system.

Here, the Dutch system presents both strengths and weaknesses. On the one hand, the Ministry of Justice's Directives on Legislation encourage regulators to consider alternative policy instruments. In the case of primary legislation, the reason(s) that alternatives have not been used must be explained to Parliament. On the other hand, there is no operational guidance on the characteristics and uses of alternatives for regulators to consult. The RIA system does not require that alternatives be identified and assessed in the impact analysis, so there is little transparency or accountability as to the choice of regulation over other options, nor even necessarily identification of the alternatives that have been considered.

Despite this, there is considerable experience with the use of some kinds of alternatives in the Netherlands, primarily co-operative forms of regulation that are related to corporatist traditions, and also with some market incentives. The co-ordinating agencies for MDW believe that alternatives are "widely and seriously considered"[16] and that the search for alternatives is partly driven by the need to find faster ways to implement policies, given the length of time taken for legislative change. There is little sign as yet, however, that the diversity and scope of alternative instruments has increased in practice in recent years.

The most innovative policy field is in the area of environmental protection, where a wide range of instruments including subsidies and taxes, Environmental Management Plans and Environmental Audits (which will be compulsory for some 300 major firms) are employed. The National Environment Policy Plan[17] emphasises the need to use "legal, financial or social instruments and information" to achieve environmental policy objectives and states that "The success of environmental policy stands or falls on the mix of instruments chosen". Here too, concerns about the length of the legislative process are expressed: "The long gestation period and lack of flexibility mean that legislation is increasingly perceived as an obstacle to social renewal."[18]

Interestingly, concern for choosing the most effective instrument is accompanied by awareness of the overall costs of regulation. Research by the National Institute of Public Health and Environmental Protection has arrived at an estimate of total environmental costs (2.7 per cent of GDP in 1995, including public and private expenditures) and projected their change over time (estimating a slight fall to 2.5 per cent by 2010).[19] Benefits have not been similarly quantified.

Alternative policy instruments used by the Environment Ministry are generally seen as mutually supporting elements, with a strong regulatory component, rather than as being a stand alone policy option. For example, firms that have Environment Management Plans benefit from the application of less detailed licensing requirements than those that do not. Firms completing the environmental audit process are similarly rewarded. Development of complex policy mixes in which various regulatory and market incentives work together has been noted in most areas where alternatives are prominent.[20]

*Tradable permits.* Tradable permits are used in the Netherlands mainly in the agricultural sector. Examples include fisheries licenses, fishing quotas for plaice and sole, manure spreading rights and milk quotas. Tradable permits have also been used in the road haulage sector (now superseded) and in inland shipping. The environment sector has not been a user of tradable permits to date, but an upcoming "green energy permits" scheme will represent a significant use of this instrument.

*Taxes and subsidies.* Tax reform has become a key aspect of Dutch environmental policy. New environmental taxes have been introduced over the last two years in a revenue neutral context (for instance the revenue of the "regulatory tax on energy", introduced in 1996, is redistributed to the payers (mainly households) in the form of reduced income taxes (households) and reduced social security contributions (small businesses)). Two other examples are income tax deductions for commuting via public transport and differential indirect tax rates to favour the use of unleaded petrol.

There has been a progressive evolution of the use of economic instruments in the Netherlands. Starting in the early 1970s with a series of earmarked charges (basically to finance environmental expenditures), it has evolved since the mid 80s toward non-earmarked taxes progressively integrated into comprehensive tax reforms. In 1997, the Dutch Green Tax Commission issued its report, recommending

a number of adjustments in the tax system. Green tax reform is a major vehicle for integrating economic and environmental policy, and can be regarded as a major piece of regulatory reform.

*Information disclosure.* Information disclosure is another alternative policy instrument that is used predominantly in relation to environmental issues. One key element, shared with a large number of countries, is the use of Environmental Impact Assessments in relation to large project proposals. Provision for EIAs has been incorporated in Dutch environmental legislation since 1987. Another widely used information disclosure strategy is the "eco-labelling" of products – that is, the provision of information to consumers on the environmental aspects of the manufacture, use and/or recycling of the product.

### Box 7. Environmental covenants in the Netherlands

Covenants, used in the Netherlands since the 1980s, are employed in most major policy areas. A survey in the early 1990s produced a list of more than 150 covenants in force, and the numbers have continued to grow. Their largest use is for environmental protection, where the number of covenants increased from 40 in 1994 to over 50 in 1998. Covenants have been concluded in areas such as basic metals, paper and cardboard production, dairy products, batteries, PET bottles, CFC and phosphate use, wastes, and in the chemical industry.

The covenant is a negotiated agreement between a ministry and industry group for specific actions to be carried out. Covenants can have a fixed or indefinite duration. The majority of covenants are concluded between a Ministry and an industry umbrella organisation (usually in sectors dominated by large firms) and bind all members of the organisation. Hence, the influence of the covenant can be far-reaching. The roots of this type of covenant in Dutch corporatist traditions are evident. Often characterised as "voluntary agreements", some covenants are in fact concluded under civil or administrative law and are legally enforceable.

The Dutch government uses covenants in three ways: as a temporary instrument pending the passage of legislation; as a supplement to legislation to achieve higher standards; and as an alternative to legislation. In all three cases, the National Environmental Policy Plan explicitly recognises the importance of securing the co-operation of target groups in achieving the objectives. In practice, the majority of covenants are concluded as supplements to legislation. Governments have been reluctant to use them as alternatives to regulation, perhaps due to uncertainties or difficulties with enforcement. It is also possible that a lack of public confidence in the instrument and a preference for clearly enforceable sanctions limits use of the covenant as a stand-alone tool.

Use of covenants as a temporary measure seems to be a direct result of the length of the legislative process in the Netherlands: When seven or more years can elapse before legislation is in place, there is considerable demand for a more responsive form of policy action.

For producers, the attraction of covenants is that they are negotiated with individual industry sectors (unlike most legislation) and the process allows more significant input. Convenants are seen as potentially more responsive to industry needs in terms of means of implementation, scheduling of requirements, and so forth.

Significant dissatisfaction arose with the early use of covenants, focusing on their lack of clear obligations to achieve results, uncertain legal status, lack of third party involvement, and concern that the role of parliament was being supplanted. These concerns were addressed via the issue of guidelines on the use of covenants. The most recent, in the form of a 1995 Cabinet regulation, includes criteria for choosing policy instruments, binding of the parties, openness, making objectives and obligations explicit, accounting for interests of third parties, dispute resolution, and evaluation.

Notwithstanding the guidelines, the making of covenants is less open to third parties than is the legislative process, and concerns about legitimacy remain. Moreover, while the guidelines require consideration of whether parliament ought to be involved, there is no requirement that this occur. Finally, there are concerns about the possible effects of these industry agreements on competition.

*Source:* Bastmeijer, Kees (1997), "The Covenant as an Instrument of Environmental Policy: A Case Study from the Netherlands", published in Huigen, Hans, ed. (1997), *Co-operative Approaches to Regulation*, PUMA Occasional Papers No. 18, OECD, Paris.

*Management Plans.* Businesses are increasingly required to develop individual management plans, based on their own assessments of health, safety and environmental risks pertaining to their specific operations. Management plans consist of priority listings, budgets, timeframes and evaluations. Environment ministry officials state that their organisation responds to the existence of realistic and relevant management plans by adopting a considerably more flexible approach to their activities.

*Replacing ex ante licenses with general rules*. One of the more damaging forms of regulation is the *ex ante* licensing or permitting requirement. These kinds of regulations increase investment delays and uncertainties, have disproportionate effects on SME start-up, and are very costly for public administrations to apply. Yet they are pervasive in OECD countries. The Netherlands has made substantial reforms in this area, although the potential for further gains remains substantial.

A significant reduction in licences and permits was accomplished by the liberalisation of the Business Establishment Law in 1996. Under the new law, narrowly defined requirements were withdrawn or replaced by general ones governing three categories of businesses: in the first group, no legal entrance requirements are required; in the second, including bakeries and butchers, some general professional skills are demanded; in the last group, specific skills are required. In total, establishment rules were reduced from 88 to eight. In practice, the reform also meant, for instance, that 60 000 retailers and hotel and catering businesses do not need any longer to obtain licences that used to cost between Gld 2 000 and Gld 15 000. They instead must simply comply with general rules and report to the local authority, at a cost of less than Gld 50. Nevertheless, because of remaining concerns about the effect on start-ups, a review of this new law will be brought forward by three years to 1998.[21]

In the environment area, one of the significant results of the MDW programme has been a significant reduction in the number of firms subject to environmental licensing. Where licenses are removed, control instead falls to the use of general regulatory standards. This significantly reduces burdens for those firms not among the highest priority areas for environmental surveillance by eliminating the paperwork and inspection burdens associated with the licensing process. As a result of this policy, the number of firms required to hold an individual environmental license has fallen from around 100 000 to 80 000 over the last two to three years and is expected to fall further.

While this represents a significant shift, over 20 per cent of Dutch firms remain subject to environmental licenses. By comparison, a similar process of reform conducted in the Australian state of Victoria over several years reduced the number of firms subject to environmental licences to around 1 600, or little more than 1 per cent of the total.[22]

*Assessment of the use of alternative instruments*. The Dutch experience with alternative policy instruments is more extensive than that of many OECD countries, and the results appear to be positive with respect to cost-effectiveness of policy delivery. Significant experience with alternatives has accumulated in some areas, with the Environment Ministry taking a leading role. The use of covenants, the substitution of individual permits for general rules, and the use of environment management plans in the permitting system have probably had large impacts on both costs and effectiveness. The use of covenants may be favoured by the consensus oriented Dutch political culture which emphasises social responsibility and would therefore tend to increase the scope for voluntarism in addressing policy goals. Delays in the legislative process have provided another incentive for ministries to develop alternatives.

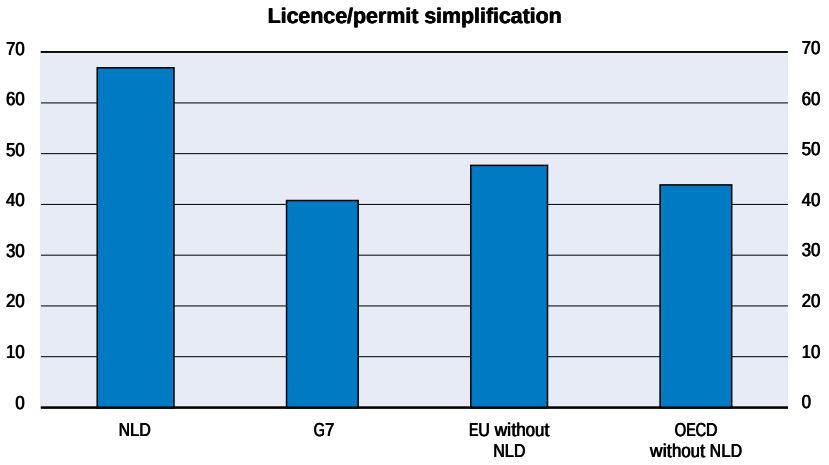
In other policy areas, however, alternatives have been slow to be embraced. For example, major reform of occupational health and safety rules to implement performance based standards is currently underway in the MDW process, though such approaches have been progressively implemented since the 1970s in a number of other countries. Questions of the legitimacy of some alternatives have been raised. These concerns appear to relate both to the concept of voluntarism *vs.* obligation, and inadequate transparency in the development and implementation of some alternatives. Not enough is known, however, and the benefits and costs of alternative instruments are ripe for evaluation.

Practices in other OECD countries suggest possible improvements to the capacities of the administration to identify alternative approaches. The Directives on Legislation include a general requirement for alternatives to be considered and used where possible and (for primary legislation) for reasons for their non-use to be set out explicitly. Yet lack of a requirement for consistent identification and analysis of the relative merits of different alternatives has slowed Dutch efforts to improve policy cost-effectiveness.

Resolving this problem requires action on a number of fronts: implementation of a formal requirement to analyse alternatives in the RIA context, strategies to ensure that RIA occurs before agencies are strongly committed to particular policy choices and strategies to ensure that there is a widespread awareness and understanding of the characteristics of a range of alternative policy instruments. The latter is often successfully combined with RIA training programmes.

Box 8. **Simplifying permits and licenses in selected OECD countries**

This synthetic indicator of efforts to simplify and eliminate permits and licenses looks at several aspects, and ranks more highly those programmes where countries use one-stop shops for businesses and the "silence is consent" rule to speed up decisions, where there is a complete inventory of permits and licenses; and where there is a specific programme, co-ordinated with lower levels of government, to review and reduce burdens of permits and licenses. The Netherlands ranks very highly on these scores relative to other OECD countries, missing only an inventory of permits and licenses that would probably be of assistance in making further progress.




*Source:* Public Management Service, OECD.

### 3.3. Understanding regulatory impacts: the use of regulatory impact analysis (RIA)

The 1995 *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation* emphasised the role of RIA in systematically ensuring that the most efficient and effective policy options were chosen. The 1997 *OECD Report on Regulatory Reform* recommended that governments "integrate regulatory impact analysis into the development, review, and reform of regulations". A list of RIA best practices is discussed in detail in *Regulatory Impact Analysis: Best Practices in OECD Countries*,[23] and provide a framework for the following description and assessment of RIA practice in the Netherlands.

Regulatory impact analysis has been formally required for new regulation in the Netherlands since 1985 through the revised Directives on Regulation issued by the Prime Minister. The original (1972) edition of the Directives was concerned with the procedural aspects of legislative quality, and with questions of law-making techniques. Thus, the inclusion of RIA broadened the tools of regulatory quality to include the *ex ante* measurement of the likely cost and effectiveness of proposed legislation.

However, the RIA requirements imposed in 1985 were ineffective. Only very general requirements were established, an approach that was recently being described by officials as "formalistic" – in essence based on answering very general questions in Cabinet coversheets – and with little supervision of the quality of work. Moreover, the focus of RIA was on indirect or "side-effects" of regulations, that is, on ensuring that impacts that might be overlooked were identified, rather than on a careful weighing of the whole impact. A review of RIA in 1994 (General Accounting Office)[24] and another in 1995 (EIM) both concluded that very rarely were full analyses of the issues described in the directive undertaken. RIA were largely conducted through qualitative analyses, and use of very general statements of effects was widespread. RIA had not developed into an adequate and reliable tool for decision-making, and as a result little was achieved via the RIA requirements in this period.

The RIA programme was completely overhauled in 1994-5 as part of the new Cabinet's policy on regulatory reform. The new RIA programme stressed co-operation between three agencies (Justice, Economic Affairs and Environment) in improving the quality of analyses. A facilitative approach was taken, with a centrepiece being a "help desk" staffed by these three agencies to which regulators could turn for assistance in completing RIA.

The general consensus today is that the degree of quantification of regulatory benefits and costs has slightly improved, but remains low. A useful indirect measure of the impact RIA is the frequency with which the RIA process has resulted in amendments to, or the abandonment of, proposals. In early 1997, it was reported that, during the first 18 months of the operation of the help desk, around 20 per cent of legislation tested was modified or abandoned. In early 1998, Dutch officials believed that a similar ratio had continued since. This is a relatively high percentage, and one which can only be increased if the current moves to investigate the feasibility of using a more explicit and quantified approach to RIA result in substantial change.

In the following paragraphs, the Dutch experience with RIA is gauged according to the best RIA practices identified by the OECD.

*Maximise political commitment to RIA.* Use of RIA to support reform should be endorsed at the highest levels of government. The Dutch system rates highly on this criterion. RIA is a central element of the MDW programme and therefore enjoys the public commitment of senior ministers in the Dutch Cabinet: the Prime Minister, the Minister for Justice and the Minister for Economic Affairs. One practical result of this support is that the Dutch RIA programme covers all legislation as well as Cabinet regulations, which is rare, and laudable, among OECD countries.

*Allocate responsibilities for RIA programme elements carefully.* To ensure "ownership" by the regulators while at the same time establishing quality control and consistency, responsibilities should be shared between regulators and a central quality control unit. The Dutch approach gets mixed reviews in this regard.

As in virtually all countries, regulatory impact assessments in the Netherlands are conducted primarily by the regulators responsible for the decisions. There is a profusion of quality control. Comments are received from other Ministries, and the Helpdesk (Ministries of Economic Affairs, Justice and Environment). The Ministry of Justice separately assesses the quality of RIA information as part of its broader quality assessment function before draft legislation goes to the Council of Ministers. An additional review is provided by the Council of State at Government request.

If the explanatory memorandum (containing the RIA) is considered inadequate, the Ministry of Justice can oppose the forwarding of the proposal to the Council of Ministers. This ability to delay the consideration of the proposal provides some incentives to regulators to ensure that the RIA is adequate. However, the power provided to the Ministry falls short of a formal requirement for approval of

the analysis, and, given the political capital required, it is probably not realistic to suppose that the Ministry of Justice is able to act consistently in blocking inadequate proposals.

Establishment of the "help desk" was expected to contribute to improving the quality of assessments in other ways. Regulators are able to discuss assessments with specialists in the relevant areas (*i.e.*, business impact, environmental impact) at an early stage. The help desk is able to assist with the design of analyses, the collection of necessary data, and its analysis and interpretation. The help desk's resources include the services of a statistician, who is available without charge to Ministries, and financing (between 700 000 and 1 million Dfl in recent years) for necessary research. Providing dedicated resources from an external source is likely to address a key problem in relation to RIA quality: the reluctance of regulators to divert scarce agency resources to impact analysis.

The Dutch RIA system involves a number of players and is unusual in OECD countries in drawing on the expertise of three different departments in implementing quality controls. This is potentially a very strong partnership. However, oversight appears to be compromised by the lack of a clear distinction between RIA review and the more general review of legislative quality by the Ministry of Justice. The split in the exercise of *ex ante* assessment of legislation in the Netherlands does not conform to a "technical legal quality" *vs.* "policy issues" dichotomy. Instead, elements of the policy process are contained within the assessment made by the Ministry of Justice, rather than within the policy based RIA process. This has historical roots and could relate to the strong role still exercised in regulatory reform by the Ministry of Justice. However, the lack of explicit accountability for RIA quality appears to reduce the scope and effectiveness of the RIA process.

In addition, the extremely active and interventionist role taken by the help desk has meant that regulating ministries feel a diminished sense of responsibility for the conduct of RIA and, arguably, for the quality of the final product. This problem is recognised within the co-ordinating ministries, who consider it to be a key challenge for the future. A strategy needs to be developed to address the issue without compromising the benefits, mentioned above, of the current interventionist approach.

*Train the regulators.* Regulators must have the skills to do high quality RIA, yet RIA is one of the few areas of regulatory reform in which detailed guidance material has not been developed and issued to ministries. Moreover, the co-ordinating ministries have not developed training programmes in RIA skills, preferring to invest in skills through the help desk function. The primary source for RIA guidance is the Directives on Legislation, since most of the issues treated in the Directives are in many countries dealt with in guidelines on the conduct of RIA.

While these guidelines are in many ways equivalent, and perhaps gain authority by being of more general application, they are not presented in terms of RIA requirements. In addition, they arguably address legal issues at the expense of economic/policy concerns. This approach must retard the development of the "cultural change" among regulators and reduce the development of a sense of responsibility for the conduct of RIA.

A major first step would be a concerted attempt to provide training and guidance materials to large numbers of policy staff within ministries. Training and guidance should emphasise the role of RIA in making good policy choices and the importance of benefit-cost principle in ensuring that social resources are used well. It should provide practical guidance on data collection and methodologies. Provision of guidance material could help achieve consistency in methodological approaches and assumptions between different RIA. It could also contribute to the co-ordinating ministries' objective of enhancing the degree of responsibility taken by ministries for their own RIA. Finally, the issue of guidance documents may need to be considered in a broader context, given the concern expressed by officials about developing "guideline inflation". Attention to the relationship between different training and guidance initiatives may be a crucial determinant of the effectiveness of this approach.

*Use a consistent but flexible analytical method.* The Directives on Legislation require that a "General Impact Analysis" be undertaken, wording that has remained essentially unchanged over the years. RIA is guided by a list of specific questions required to be answered. There are currently 15 questions,

covering business effects (7 questions), environmental effects (4 questions) and feasibility and enforceability (4 questions). The nature of the questions is such that a broad view of the effects of the proposed legislation, covering both costs and benefits, is required. However, the questions are, apparently deliberately, expressed in a way that does not imply quantified answers.

Additional detail on the costs to be considered in weighing regulatory proposals and alternatives is provided in the Directives on Legislation. These lists cover costs both to the private sector and to government. However, while departments are formally required to consider these costs, there is no requirement to document the costs in the RIA. Thus, there is little basis for ensuring that this element of the Directives is complied with in practice. The absence of a formal requirement for benefit/cost analysis means that there are few incentives for ministries to quantify and compare the various impacts of regulatory proposals.

Improved training and guidance material may stimulate more extensive and quantified RIA analyses that are better able to guide decisions. A more explicit requirement for quantification, such as the adoption of a formal cost/benefit test, would clarify that all reasonable steps toward quantification are required to be taken. The record in OECD countries shows a trend for more precise and analytical RIA requirements to be adopted, covering a wider range of impacts, as experience with RIA accumulates and expertise develops, and as policy officials become more sophisticated as consumers of analytical information. Since the commencement of this review, the Dutch Government has commenced an inquiry into the feasibility of implementing a more formal requirement for quantified benefit/cost analysis to be conducted in respect of draft legislation.

*Develop and implement data collection strategies.* As noted, training and guidelines have not been a part of the RIA programme to date. However, the help desk function has included the availability of a specialist statistician as well as the ability to make funding available to conduct RIA research. Thus, assistance is available to ministries in collecting and analysing data. Nonetheless, development of guidance on various methods of data collection for RIA would improve ministry responsibility for RIA and reduce the burden on help desk resources.

*Target RIA efforts.* RIA resources should be targeted to those regulations where impacts are most significant, and where the prospects are best for altering outcomes. In all cases, the amount of time and effort spent on regulatory analysis should be commensurate with the improvement in the regulation that the analysis is expected to provide.[25] Dutch RIA efforts perform well here. The RIA requirement initially applied to all draft legislation and Cabinet level regulation, although regulations made by individual Ministers have been, and continue to be, excluded for reasons of perceived practicality. But changes made in 1994 have moved toward a more selective approach. In the first instance this means restricting the RIA requirement to only those proposals that meet certain criteria. As a result, only 8 to 10 per cent of regulations are currently being selected for assessment.

Secondly, the questions to be addressed in the RIA are adapted to the specific regulation. The Ministerial Committee reviews the regulatory proposals and determines which of the 15 questions contained in the Directive must be answered for each regulation. This “customisation” of the RIA requirement has been taken quite far, with no case having occurred since 1995 of every question having to be answered for a single regulatory proposal.

Another aspect of coverage relates to the treatment of European legislation. Although it has been subject to impact assessment since 1986, the quality of these assessments in practice has generally been low. Yet national legislative quality is, for an EU Member, closely related to the quality of EU legislation. In July 1996, the Ministers for Economic Affairs and Justice informed Parliament that a “limited number of important Brussels dossiers will be subjected to an assessment based on MDW aspects”.[26] The co-ordinating ministries believe that the RIA processes should be developed to enable a flow of information on regulatory impacts to the European Commission to improve its ability to conduct RIA on proposed Community law. This is consistent with attempts during the Dutch Presidency of the EU to focus on means of improving RIA in the European context.

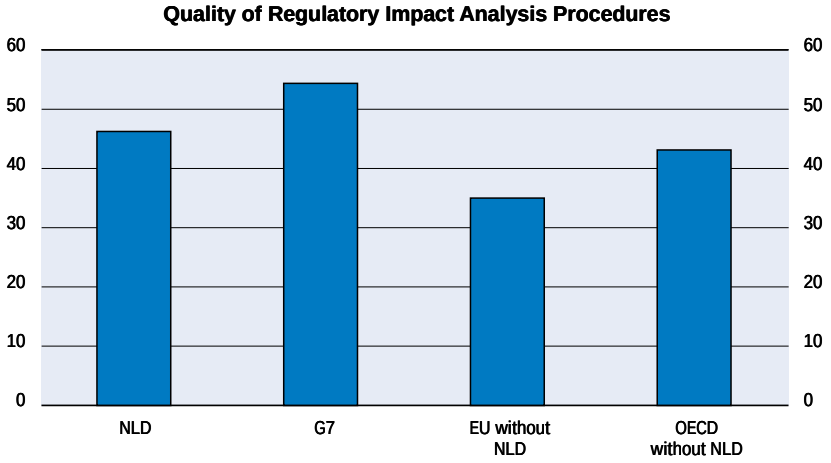
*Integrate RIA with the policy-making process, beginning as early as possible.* Regulatory reformers in the Netherlands emphasise that the approach adopted by the help desk is a co-operative one and that this has been successful in encouraging regulators to make use of the expertise made available. A 1996 evaluation (IME Consult) found that most regulators now see RIA as "an essential and natural part of their policy choices" and "expect it to speed the decision-making process on legislation in the Council of Ministers due to the improved preparation".[27]

Notwithstanding this, the Ministry of Justice states that approximately 10 per cent of legislation subject to its quality control is regarded as inadequate, even after discussions with the ministries involved. Evidence suggests that the effectiveness of RIA has been constrained in part by the fact that ministries have a significant commitment to a particular regulatory approach by the time RIA is applied. They are thus reluctant to modify them even where weaknesses are demonstrated by the analysis, a tendency that can only be exacerbated by the length of the legislative process.

The Ministry of Economic Affairs identifies as a key challenge the need for the help desk to become involved with ministries at an earlier stage, to ensure that RIA is commenced earlier, and thus improve its ability to change policy where analysis points to weaknesses. This will require a more proactive approach in identifying and selecting dossiers for analysis as well as improving knowledge of RIA requirements and encouraging better consultation. Implementing a training programme, supplemented by guidance materials, as discussed above, would also make a significant contribution.

### Box 9. Use of Regulatory Impact Analysis in the Netherlands

This synthetic indicator of the application and methodology of regulatory impact analysis looks at several aspects of the use of RIA, and ranks more highly those programmes where RIA is applied both to legislation and lower-level regulations, where independent controls on the quality of analysis are in place, and where competition and trade impacts are identified as well as the distribution of effects across society. It also ranks more highly the use of RIA documents for consultation purposes, RIA programmes where benefits and costs are quantified, and where a benefit-cost test is used in decision-making. The Netherlands has a middle ranking score on this indicator, being slightly ahead of the OECD average and somewhat ahead of the EU average, but behind the G7 average. Key shortcomings in terms of performance on this indicator are the failure to adopt a benefit-cost test (although this is now under consideration), to quantify costs and benefits consistently and to release of RIA documents for consultation. Better integration of RIA and consultation is identified as a key policy priority in this report.




*Source:* Public Management Service, OECD.

*Involve the public extensively.* Impact assessments on primary legislation are submitted to Parliament as an input to its decisions. As a result, they are made publicly available prior to the legislation being debated and adopted. However, there are no formal publication requirements other than those applying to all tabled documents. Thus, the level of awareness of RIA is low. There is no formal mechanism for soliciting public comments on the basis of RIA. While the Netherlands has a highly developed public consultation process, it is not integrated with RIA. The opportunity to use consultation as an additional quality control on RIA, by exposing assumptions and methodologies to scrutiny and argument from affected parties, is lost.

The situation is still less transparent with regard to RIA for Executive Orders and Ministerial regulations. RIA are submitted to Cabinet as a guide to decision-making. However, unlike the case with submission to Parliament, this does not imply any public availability of the analysis prior to the adoption of the regulation. The analysis is, however, published as part of the explanatory notes to the regulation after adoption.

Involving the public in the development and review of RIA is a high priority for improvement of Dutch RIA processes. The extensive nature of consultation in the Netherlands provides an excellent opportunity to improve the quality of RIA at small extra cost.

*Apply RIA to existing as well as new regulations.* RIA disciplines are equally useful in the review of existing regulation as in the *ex ante* assessment of new regulatory proposals. Indeed, the *ex post* nature of regulatory review means that data problems will be fewer and the quality of the resulting analysis potentially higher. Currently, there does not appear to be a high degree of consistency in review methodologies in the Netherlands. There are no standardised evaluation techniques or decision criteria promulgated as the basis for conducting review. Cost savings or enhanced benefits likely to flow from reform proposals are frequently quantified, but a formal regulatory impact analysis approach is not widely used. This is a major area in which RIA could be better used to improve regulatory performance.

## 4. DYNAMIC CHANGE: KEEPING REGULATIONS UP TO DATE

The *OECD Report on Regulatory Reform* recommends that governments "review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively". In the Netherlands, institutionalised processes have been established for the review and reform or elimination of the large body of existing regulations, and much review activity has been undertaken. A high level of independence and transparency has been designed into these processes. There are also explicit programmes to review and reduce red tape and government formalities, which have had some success to date and are being broadened and further developed. These include reforms to key areas of business licensing as well as paperwork burdens.

However, there is not a high degree of consistency in review methodologies. There are no standardised evaluation techniques or decision criteria promulgated as the basis for conducting review. Cost savings or enhanced benefits likely to flow from reform proposals are frequently quantified, but a formal regulatory impact analysis approach does not appear to be widely used. As the Chair of the Social Economic Council observed, "We are better at making laws than at revising them".[28]

*Reviews under the MDW programme.* Targeted review of specific areas of regulation are carried out under the MDW programme. These reviews can relate to a particular regulatory "theme", or to an industry, activity or profession. The reviews are expected to be completed on an approximately annual cycle, and the MDW programme has passed through four "stages" since its launch in 1994. Review proposals are formulated by the Civil Service Commission and submitted to the MDW Ministerial Commission for approval. Selection of issues for review is based on several criteria:

- Economic significance of the subject.
- Likelihood of achieving fewer regulations and thus stimulating the economy and increasing employment.
- Whether dealing with the subject in the MDW framework adds value.
- Practical considerations, such as whether the project can be completed within one year.
- Considerations with respect to the equilibrium and representativity of the overall package.

Box 10. **Activities reviewed under the MDW programme**

*1st phase projects:*

- Shop trading hours
- Taxis
- Environmental licenses
- Occupational health and safety regulation (move to performance basis)
- Driving hours (trucks)
- Legal practice monopolies
- Quality of EU regulation
- Standardisation and certification
- Citizens' contributions to collective organisations

*2nd phase projects:*

- Food legislation
- Hospital care (market based reforms)
- Noise pollution Act (decentralisation of implementing authorities)
- Higher education (more market based)
- On-charging of enforcement costs (general)
- Insurance agents (freeing entry to the profession)
- Compulsory professional pension schemes (relaxing/removing requirements)
- Partnership law reform (streamlining supervision requirements)
- Payments to local governments (streamlining administrative processes)
- Market and government (*i.e.*, competitive neutrality/withdrawal of government from commercial operations).

*Third phase projects:*

- Competition clause (review of laws enabling employers to bind former employees not to compete with them for a certain period after leaving their employ)
- Accountancy (review of professional regulation)
- Health care (market based reforms)
- Surface Water Pollution Act (permit reforms)
- Product legislation (rationalisation of legislative requirements & review of substantive laws)
- Bailiffs (review of professional regulation)
- Construction regulations (reducing and streamlining regulatory requirements)

*Fourth phase projects:*

- Estate agents
- Pilotage service
- Supervision and co-operation of copyrights
- Electronic performance of legal acts
- Access to the Health Insurance Act
- Business licensing procedures
- Petrol retailing

Selection of areas for review by the Civil Service Commission includes an element of consultation with relevant interests including employer and employee groups, consumer associations, special interest groups (*e.g.*, environmental groups) and the parties responsible for implementation of the regulations. Once the Ministerial Council has approved the reviews, Working Groups are established to conduct research and draft reform proposals.

Legislation reviewed during this time includes significant elements of both social and economic regulation. In the former category are reviews of occupational health and safety, environmental permits, hospitals, product liability and food regulation, while reviews of economic regulation have included the regulation of lawyers, accountants, real estate agents, the electricity industry, and taxis and professional pension schemes. In addition, action has been commenced on particular legislative themes of general application, such as the potential use of certification as an alternative form of regulation.

*Cutting Red Tape.* The OECD Report noted that governments should place a high priority on reviewing and reforming government formalities, particularly those that overload SMEs. Streamlining and reducing these burdens can free up scarce human and financial resources for more productive activities, and open opportunities for new businesses.

Reducing the administrative costs of compliance with regulations and taxes has been a major policy thrust for 10 years. The Netherlands has developed a range of policy responses to the problem, including one-stop shops, inventories of formalities, and programmes to reduce licenses and permits. No independent assessment of the success of these approaches exists, though self-assessment by the ministries indicates that they have cut some existing burdens. Hiring employees for the first time is still complex and expensive, particularly for SMEs.[29] It appears that at best, the Netherlands has stopped, or perhaps slightly reduced, the growth of the paperwork burden.

Since the early 1980s, the Netherlands has launched a series of initiatives to assess and reduce administrative burdens. Special commissions, like the Grapperhaus Commission (1985) and the Van Lunteren Commission (1994) demonstrated a high level of political concern in this area. The efforts have been sustained by a constant endeavour to refine reliable cost assessment tools (see Box 11) in this difficult area. In 1994, these efforts crystallised into a programme to reduce administrative compliance costs as one of the three elements of the MDW programme. The programme is the responsibility of the State Secretary for Economic Affairs and its progress is reported annually to Parliament. It focuses both on streamlining the content of regulatory requirements, and on improving government efficiency in applying regulations.

The 1994 programme has a number of elements. First, the government committed to reduce aggregate administrative compliance costs by 10 per cent from 1994 to 1998. Ministers were asked in 1995 to self-assess the possibilities for burden reduction within their portfolios to achieve that figure. This resulted in a reform plan that is being implemented under the supervision of a group of senior officials representing all agencies involved.

Second, the State Secretary consults regularly with a panel of about 20 entrepreneurs, mainly from the SME sector, to identify further options for reform.

Third, reforms have been supported by a re-engineering of formalities and development of cost-effective alternative ways to apply them. For instance, several projects are underway to reduce burdens by better use of information and communication technologies. The government has continued to establish and expand one-stop shops for SMEs (Ondernemershuizen or “business houses”) in local chambers of commerce and other business organisation to help SMEs with information and problem solving instruments.

Results of the administrative burden reduction programme were assessed in 1996 through a process of aggregating the reductions made and comparing the total to the initial (1993) total burden figure. It was stated, though not documented, that the target of a 10 per cent reduction in burdens had been met,[30] and a new target of a 25 per cent reduction was set. Measurement of performance undertaken was "static", that is, it ignored additional burdens imposed due to new requirements. Hence, the 10 per cent reduction in burdens represents not a net reduction but a reduction of those burdens existing in 1993. This is consistent with the approach taken in other programmes of this sort, including the US Paperwork Reduction Act programme, but not terribly satisfying to businesses who might expect that their administrative costs would decline as a result of the programme.

### Box 11. Calculating administrative compliance costs in the Netherlands

Relative to many OECD Member countries the Netherlands has been a leader in the assessment of administrative costs on businesses. Two complementary methodologies have been used: evaluation through opinion surveys ("top-down approach") and assessment of the potential costs of relevant regulations through modelisation ("bottom-up approach").

*Top-down approach: business surveys*

In 1993, the Ministry of Economic Affairs commissioned EIM, a consulting firm, to carry out a business survey to estimate administrative compliance costs. The survey found that total costs were Gld 13.1 billion, or more than 2% of GDP. Compliance costs of taxes and levies were Gld 6.1 billion (47%), those of labour-related regulations amounted to Gld 1.41 billion (10.8%), while compliance costs of eight business-related regulations, including environmental regulation, amounted to Gld 5.54 billion (43.3%) (OECD 1995, p. 10). The results of this survey can be compared to a 1989 survey undertaken by the Centre for the Economics of Local Government of the University of Groningen. Both studies found that compliance costs fall relatively more heavily on smaller enterprises than large ones, and that taxes and levies play an important part in the administrative compliance costs. It is interesting that the 1993 survey showed higher aggregate costs than did the previous survey. This may be due to differing definitions in the two surveys, but may also reflect actual increases in administrative costs (related to environment, municipal taxes, import/expert regulations and transport areas). However, a lower estimate is obtained for taxation for 1993. This may be due to an increased use of IT among businesses and simplifications related to tax law reform.

*Bottom-up approach: the MISTRAL project*

Since 1985, the Dutch government has been developing and refining a computer model, MISTRAL, to evaluate the business impact assessment of regulations. MISTRAL works in three stages: *a*) an in-depth analysis during which all "data transfers" between a business and the authority (*e.g.* a document, a telephone call, and inspection, etc.) are isolated and defined; *b*) the time involved in each "data transfer" and the function level of the person performing it (related to professional qualification and hourly wage-rate) are then determined; *c*) the data are compiled by the computer to produce cost estimates. The two first steps are based on a multi-stage process of intensive consultation and discussion – individually and in groups – with experts from firms, accountants, employers and enforcing authorities. MISTRAL has been used to quantify administrative compliance costs of different laws and regulations, including evaluation of the information requirements of labour law, annual accounts, corporation tax, wage tax and social premiums, legislation concerning working conditions and environmental legislation.

*Source:* Van der Burg, B.I. and Nijsen A.F.M., *How can Administrative Burdens of Enterprises be Assessed? Different Methods: Advantages and Disadvantages*, published in Kellerman, A.E.; Ciavarini Azzi, G.; Jacobs, S.H.; and Deighton-Smith, R. (1997), *Improving the Quality of Legislation in Europe*, T.M.C. Asser Instituut/Kluwer Law International, The Hague, p. 268-269; Communication from the Ministry of Economic Affairs (1993).

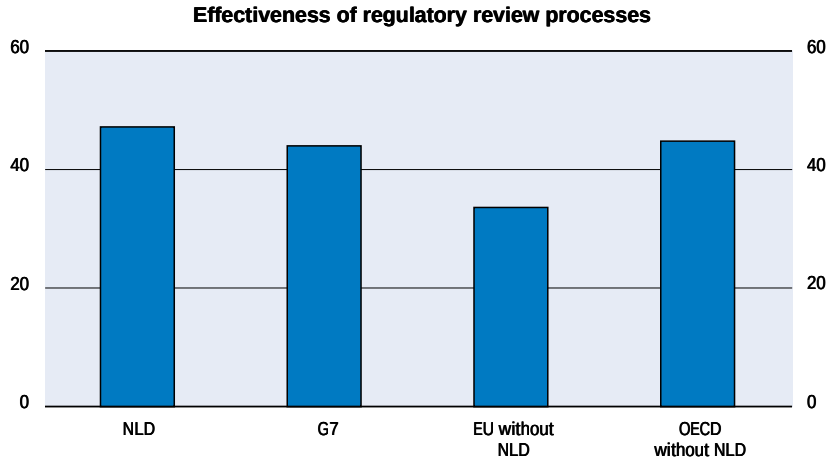
The goal of reducing administrative burdens is also reflected in the two other major elements of MDW. Reducing burdens is one of the criteria employed in selecting candidates for "special project" status. Administrative burdens are explicitly considered in regulatory impact assessments. A recently proposed initiative would systematically bring business into the *ex ante* assessment of burdens in a manner similar to the Danish Business Test Panel.

Since the mid 1980, the Ministry of Finance has reformed and modernised the tax system. This was complemented by an important reform from 1987 to 1992 of the Tax and Custom Administration (TCA). The improvements include: unification of the tax base for wage tax and social insurance contribution; the establishment of specific units to deal with all tax affairs assigned to firms ("clients"), and the re-organisation of tax audits and the use of risk analysis in order to single out businesses which need special scrutiny, while *bona fide* conduct of firms is rewarded with more lenient and less frequent handling. TCA has also been experimenting with the use of electronic data interchange (EDI) to replace paperwork.

After nearly 6 years work, the Ministry of Social Affairs and Employment established a new system to process entitlements and benefits based on individual records. This has reduced the number of items on the annual statement required by the Joint Administration Office (GAK), which co-ordinates the thirteen insurance boards in the country, from 55 to 7 per employee. GAK has also established a single information retrieval and distribution centre where businesses can send information to be distributed to various GAK units. Eventually these centres should be extended to include other administrative agencies (TCA, pension funds, national health insurance, Central Bureau of Statistics, etc.). GAK has also been working on the use of electronic means (Videotext, and EDI) to reduce paperwork and automate the information requirements based on businesses' owned computer systems. A promising experiment consists of providing employees with a chip card where all the necessary information can be updated and retrieved by employers.

### Box 12. Effectiveness of regulatory review processes in the Netherlands

This synthetic indicator (based on self-assessments) of regulatory review processes looks at several aspects of methodological quality in the review and reform of existing regulations. It ranks more highly reviews that use standardised evaluation methods incorporating RIA, that include independent quality checks, and that are open to the public. The indicator includes a self-assessed measure of the frequency with which reviews have led to concrete changes. The Netherlands ranks about equal to the OECD average on this score, but somewhat ahead of the average for EU countries. It is weak on use of standardised methods including RIA and the ability of the public to identify areas for review.




*Source:* Public Management Service, OECD.

Based on the Grapperhaus Commission recommendations the Central Bureau of Statistics has implemented a policy to reduce real and perceived (which according to some studies is 10 times higher than the real) compliance costs of statistics collection. The initiatives underway include: reduction in the size of questionnaires; decreasing the frequency of surveys, and setting up a sample system in order to avoid, whenever possible, selecting the same firms for different studies in short periods of time. Other initiatives to reduce burdens concern the use of plain language in information requirements, establishment of electronic links with larger firms, targeting of "information operators" (*e.g.* accountants, consultants, administrative agencies) in order to make better use of existing records held by other parties and offices, and establishment of "delivery and distribution points" (DDPs) to provide a single collection point for all employee-related data.

*Legislated review provisions.* A review mechanism frequently used in the Netherlands is the inclusion of a requirement in a law requiring that it be reviewed within a certain period. These may be "one off" in nature or may require regular reviews. "Sunsetting", or automatic repeal after a certain period of operation, is also sometimes used in relation to both primary and subordinate legislation. These mandated reviews are frequently conducted by independent consultants (*i.e.*, external to government). The Government is currently giving consideration to ways of making such review activity more systematic by developing a specific legislative review policy.

## 5. CONCLUSIONS AND POLICY OPTIONS FOR REFORM

### 5.1. General assessment of current strengths and weaknesses

In 15 years, the Netherlands has installed much of the administrative infrastructure to produce high quality regulations and to promote and carry out beneficial regulatory reforms. New disciplines have been built into the administration. Institutions with responsibility and incentives for good regulation – and with accountability at the highest political levels – have been created to make things happen. Quality standards based on good regulatory principles; decision tools such as regulatory impact analysis; and more transparent processes such as open public consultation have been adopted. Reductions in administrative burdens have decreased some costs. Innovative policy instruments are used more often than in most OECD countries.

In these formal aspects, the Netherlands ranks high among OECD countries. The combination of competition, deregulation, and good regulatory quality shows potential to be an effective policy mix for improving economic dynamism, while maintaining protection. Moreover, the reform programme is itself extraordinarily dynamic, the debate inside and outside the administration is well-informed and vigorous, and the search for better solutions continues through a pragmatic results-oriented approach. This flexible pragmatism is perhaps the greatest strength of the Dutch reformers.

These reforms have not been easy – much regulatory reform and its move toward market principles, transparency, and empirical decision-making has struggled with the powerful entrenched habits and interests of the traditional corporatist state, as well as the universal conservatism of public administration that makes innovation difficult. Although major consumer groups have become more supportive of reform, there are still substantial fears about the impact of reform on traditionally high levels of protection for citizens, about impacts on the environment, on the Dutch life-style, and on distribution of wealth in a society that highly values equity.

Reform has been aided, however, by the integration of European markets under the policies of the Single Market programme, and the opportunities for fast-moving, dynamic enterprises in traded sectors who now tend to see domestic competition as a strength in Europe rather than as a threat.

Yet the considerable investment in processes, administrative reforms, and proposals has yet to produce the results expected. Several years were lost by relying too much on directives, guidance and good intentions, and not enough on political commitment and institutionalised pressures. This lesson was learned, and a profound restructuring of the reform programme took place in 1994.

The 1994 programme is built on a more realistic understanding of the difficulties in introducing reform into public administrations, and important reform tools have been developed and put into use. However, many areas of economic and social policy are as yet untouched, particularly in sheltered sectors and in public sector activities. Many areas of regulation are still too detailed and unnecessarily burdensome for enterprises, particularly for SMEs. There remains tremendous scope for efficiency gains in streamlining and eliminating administrative formalities. For example, administrative barriers to self-employment linked to the tax and social security systems have a negative impact on entrepreneurship, while administrative costs for hiring employees are still among the highest in OECD countries.[31] Anti-competitive practices are pervasive through the sharing of regulatory powers with industrial organisations, with little control and transparency in how those powers are used. A serious problem is that little

monitoring of the impacts of previous reforms was undertaken. As a result, assessments must be piecemeal, indirect, qualitative, and tentative.

Even in the areas where reforms have been identified, implementation of proposals has been very slow, reducing the concrete benefits of reform. Legislative changes as a result of MDW have, to date, been limited, although larger numbers have, in very recent times, begun to bear fruit. At the commencement of this review in April 1998 only three significant reforms had been implemented: the substantial (though still partial) liberalisation of shop trading hours; the first stage of an ongoing programme of reducing the number of businesses subject to environmental licensing; and removal of lawyers' monopoly rights to represent clients in legal proceedings. By early 1999, 9 of the 36 MDW projects started between 1994 and 1998 had been finalised, while a further 6 had produced significant results, though as yet were unfinished.

Nonetheless, the Central Planning Bureau has concluded that regulatory reform has already had a measurable impact on consumer prices (see Chapter 1 for more detail on the macroeconomic effects of reforms to date). A much larger number of reforms are expected to emerge over the next few years, with 36 additional legislative proposals now in train as a result of MDW efforts. A target has now been adopted of completing reforms within a single Cabinet period – *i.e.*, four years. While this indicates recognition of the importance of this issue of policy responsiveness, it may also raise questions about the feasibility of maintaining reform momentum toward the end of Cabinet periods, as well as those of the likelihood that more complex and difficult – but potentially more important – reforms will be undertaken.

### 5.2. Potential benefits and costs of further regulatory reform

It is likely that the benefits of further steps to improve the capacity of the public sector to reform regulations and to ensure that new regulations are high quality will be substantial in terms of policy effectiveness and economic performance.

The Dutch are demanding consumers of public services often delivered through regulation, such as environmental protection, consumer protection, health, safety, and many others. Tools such as regulatory impact analysis and rigorous application of government-wide quality standards can be powerful in designing better regulations to deliver policies more effectively. Higher quality RIA can, for example, reduce the risks of policy failure. More to the point, delivering such services more cost-efficiently allows more services to be provided. This has been seen in other countries, where use of tradable permits in air emissions has so reduced the costs of pollution reduction that tighter standards are possible. Disciplines on regulatory quality are part of a larger trend toward results-oriented and accountable government focussed on service quality and consumer choice.

Moreover, moving more quickly in response to identified problems should improve the capacities of the Dutch administration to respond to fast-moving social issues, and to correct policy failures as they arise, with positive implications for the legitimacy of the public administration.

Reform can also enhance the opportunities of Dutch citizens to be actively involved in the legislative processes of government. Indeed, development of new opportunities to date has already been considerable through changes to consultation systems. More can be achieved, especially through integration of consultation and impact assessment, ensuring that the expertise of Dutch stakeholders is fully harnessed as a policy-making resource.

Yet regulatory quality reforms can have costs, too. If carried out inefficiently or mechanically, they can slow down the entire regulatory process, further reducing the benefits of both regulatory and reform actions. While it may indeed be beneficial to slow down poor proposals, this should be done selectively through well-tuned filters. In addition, the administrative resources needed for the kinds of quality investments discussed here must probably be diverted from other uses that themselves have value, and hence opportunity costs must be considered carefully. In addition, changes to decision processes can destabilise the balance of interests that often permit progress, even if it is slow and step-by-step

progress, and therefore have perverse effects on the capacity to reform. Speed and empirical rigor are not necessarily nettles that must be grasped at every step.

On the economic side, faster adjustment to changing conditions in European and international markets will reduce the costs and efficiency drags of outdated regulations. These reforms can boost productivity in many sectors of the Dutch economy. Yet the main benefits for economic performance due to reducing regulatory barriers and administrative formalities are likely to be dynamic in nature. These kinds of reforms can stimulate innovation, entrepreneurship, and investment. Policy responsiveness and regulatory efficiency are likely to be relatively more important for the Netherlands, as a small, relatively open export-driven economy, than for larger economies, and hence regulatory reform is relatively more valuable to the Netherlands.

### 5.3. Policy options for consideration

Good practices in OECD countries, as outlined in the various OECD reports and agreements among OECD countries, suggest that the Netherlands would benefit from several steps to improve the responsiveness, accountability, and transparency of regulatory reform.

- *Accelerate the scope and pace of reform by reducing the time required for reform proposals to be considered and implemented.*

A key issue for the Netherlands is the lack of policy responsiveness implied by the extremely long law-making process. The seriousness of this problem has been recognised by the Dutch government at least since the 1991 General Legislative Policy. The General Accounting Office (Algemene Rekenkamer) has found that the average time taken from policy proposal to final implementation is seven years; completely new laws and major substantive revisions can take ten years. The GAO found that more than half of this time was taken in preparation within Ministries.[32] The length of the legislative process is the key reason that the current programme has produced so few benefits. Only 9 of the 36 MDW projects undertaken in 1994-1998 have been finalised. Others are still in the pipeline. As European integration accelerates under the single monetary policy, the incapacity to react more quickly than this could impose substantial costs on Dutch businesses.

The length of time needed for legal change has other negative effects on the quality of the national regulatory system. Ministries are less willing to implement new regulatory quality procedures when their ability to satisfy demands from constituencies for new legislation is already constrained by lack of legislative capacity. Also, ministries have incentives to prefer non-legislative policy actions that enable them to act more quickly. Such alternatives can often be preferred on efficiency and effectiveness grounds, but incentives to use them as timesaving measures are likely to be perverse.

Reform in this area will be difficult, since lengthy decision processes are typical in corporatist systems, due to the number of interests who must be consulted and whose consent must be gained. Action has already been taken in three areas: the legal requirements to hear advisory bodies, their role in relation to European legislation and the parliamentary handling of draft legislation. Significant changes have been made in the first two areas in particular. Evidence suggests that there has been a significant improvement to date, consistent with the current internal target of completing reform actions within a single, four-year Cabinet period. However, an average of four years remains a long time for regulatory development and continued effort in this area is essential.

A review of the specific effects of these recent changes would be a useful step toward considering the direction of further reforms within the line ministries, where much of the problem lies. Although contexts differ greatly, consideration could also be given to the approach taken by the United Kingdom to increase the flexibility of the regulatory system by addressing a lack of legislative capacity in the legislature. The U.K. Deregulation and Contracting-Out Act of 1994 allows ministers to more easily amend or repeal problematic laws. The Act provides “a mechanism to change primary legislation for the purpose of removing or reducing burdens on businesses or others, provided that necessary protection is not removed”.[33] Under the Act, ministers may amend or repeal laws by ministerial order, but must consult those affected and provide to the Parliament a document giving the reasons for the change; the

benefits in terms of cost savings, new market opportunities, and reductions in constraints; and details of protections provided by the order. Such orders require the positive approval of both houses of Parliament, as well as 60 days for parliamentary scrutiny. Other countries have used omnibus legislation, in which many reforms are packaged together on an accelerated time schedule.

Ironically, one current time-saving measure has the effect of undermining the impact of reform. The MDW criterion of reviewing only those areas where reviews can be conducted within an annual timeframe largely eliminates the possibility of reviewing more complex (but potentially highly relevant) areas of concern. It would be preferable to put more time into the review stage, and less time into the adoption/implementation stage.

- *Strengthen accountability for results within the ministries through development of measurable and public performance standards for regulatory reform.*

One of the strong points of the Dutch reform system is the development of new institutions to promote and drive cross-cutting reforms. The ministerial committee headed by the Prime Minister, and the impressive efforts of the Ministries of Justice and Economic Affairs, have been and will continue to be instrumental in getting reform actions underway.

Yet capacities for central direction are not balanced by effective incentives for the ministries to change themselves, particularly given offsetting pressures from their constituencies and from the political level. In particular, the objectives of the regulatory reform programme are formulated at a high level of generality, and transparent measures of performance for each ministry have not been adopted. That is, objectives are strategic rather than results-oriented. Hence, accountability for results is overcentralised, whereas the skills and resources for reform are decentralised. The fact that incentives for the ministries to produce good regulation are still not very strong may be one explanation for why the regulatory habits of the administration have not changed very much.

If the scope, depth, and pace of reform is to increase, the programme should mobilise the energies of the line ministries by reforming incentive structures through development of performance standards for quality regulation, and linkage of those standards to fiscal budgeting and other credible review mechanisms. These kinds of measures are not well developed in OECD countries with respect to regulatory reform, though they are under development in many other policy areas in many countries, including the Netherlands.[34] One possible model is the U.S. Government Performance and Results Act of 1993, which established a government-wide system, including for regulators, to set goals for programme performance, measurement, and publication of results.[35]

- *Improve the contribution of RIA to good regulatory decisions by increasing methodological rigour, including adoption of a benefit-cost test; expanding it to incorporate detailed consideration of alternatives; and integrating RIA with consultation processes.*

The Dutch RIA programme is in some ways strong. It applies to both primary and subordinate regulation, is targeted toward major regulation, and includes a highly developed and well resourced system of assistance for ministries from co-ordinating agencies. Changes made since 1994 to the RIA system significantly improved its potential to contribute to regulatory quality. For example, targeting of RIA requirements to only the most significant regulations concentrated limited resources to their highest value in improving the cost-efficiency of regulations.

In particular, provision of significant resources through the help desk function is innovative and worthy of consideration by other OECD countries. Creation of a dedicated budget to fund analysis can help to overcome agency reluctance to divert resources to RIA, as can access to dedicated statistical resources from the help desk. The use of three co-ordinating departments to ensure that various aspects of regulatory quality are properly considered is another promising practice.

Yet the RIA programme has not been very effective in producing reliable data that can increase the cost-efficiency of regulatory decisions. OECD best practices suggest that three key steps are needed to

improve its effectiveness: 1) increase methodological rigour by providing training, written guidance, and minimum analytical standards including a requirement for benefit-cost tests to line ministries; 2) expand RIA to incorporate detailed consideration of alternatives; 3) ensure greater public scrutiny through integrating RIA with consultation processes.

First, the degree of quantification of regulatory benefits and costs remains low. Training and guidance for policy staff in the ministries would be a useful step, and adoption of standard minimum requirements such as quantitative analysis of direct costs of compliance through tools such as the Canadian Business Impact Test. Adoption of an explicit benefit-cost principle, as is currently being considered, would sharply improve the quality of regulatory decisions. The practical and conceptual difficulties of a formal benefit-cost analysis suggests that a step-by-step approach is needed in the Netherlands, in which the RIA programme is gradually improved, integrating both qualitative and quantitative elements of the analysis, so that over time it better supports application of the benefit-cost principle.

Second, the usefulness of RIA in promoting use of cost-effective policy tools would be significantly enhanced by a formal requirement that feasible alternatives be analysed and compared with the regulatory proposal. MDW does not appear to have had a significant impact in the rate of adoption of alternative policy instruments. While the performance of the Netherlands is relatively good with respect to use of innovative instruments,. the use of environmental covenants, while still growing, does not appear to have accelerated as a result of actions taken under MDW. More rigorous assessment of alternatives should help identify a wider range of areas where they are the better choice.

The effectiveness of both of these strategies would be enhanced by integration of RIA with consultation processes. Publication of RIA through a procedure that required regulators to respond to comments from affected parties would enable consultation to function more effectively as a means of cost-effective information gathering, and thereby improve the information needed for good RIA. Access to RIA would also improve the quality of consultation by permitting the public to react to more concrete information. Such integration should, however, be carefully designed so that additional delays to the policy process are not introduced.

- *Further encourage the use of cost-effective alternative policy instruments by developing operational guidance for ministries.*

As suggested above, a requirement that analysis of alternatives currently required by the Directives on Legislation be documented and subjected to public scrutiny through the RIA process could stimulate genuine comparisons of the benefits and costs of various approaches. However, policy makers are likely to require assistance in the identification of suitable alternative policy tools. Operational guidance on the characteristics and use of alternative approaches should be developed for use by the line ministries. Such guidance has been useful in several countries such as Australia and Canada. The current help desk structure would seem to be well-placed to support such an initiative by providing expert assistance in relation to particular policy issues, particularly to the extent that it succeeds in its current aim of becoming involved with ministries at an earlier stage in the policy process.

- *Improve transparency by extending requirements for transparency to non-governmental bodies with delegated regulatory authorities, and by publishing a plan of major upcoming regulatory actions.*

A form of regulation widely used in the Netherlands is that of "co-regulation", or sharing of the regulatory function between government and industry. This has been implemented predominantly through the professional board structure. Such industry based regulatory and enforcement systems can have major benefits in terms of cost and effectiveness, but in many countries professional bodies have used this role to limit competition and increase incomes and, hence, consumer prices. The incentives that exist for rent-seeking require that governments carefully supervise the use of such delegated regulatory powers.

Two mechanisms currently in place are expected to have a significant impact. The new competition law should eliminate or restrict many anti-competitive practices, although the legislation on surveillance of PBO regulations is weaker in important respects than initially proposed by the Government due to changes made in the Parliament. These include, in particular, the 5 year exemption of PBO regulations

from the competition law and the exemption of a range of these from requirements for prior approval by Parliament, rather than provision for *ex poste* disallowance. (For further details, see the background report on The Role of Competition Policy in Regulatory Reform). The extent of this effect will also clearly depend on the attitude taken by the competition authority in processing requests for exemptions. Secondly, the regulation of several professions has been considered by working groups under the "Special Topics" element of the MDW programme and a number of deregulatory initiatives are in process.

A useful additional step would be development of clear governmental guidelines on the use of regulatory powers, including issues such as the representation of independent "public interest" advocates, the review role of competition authorities, and the need for specific legislative authorisation of regulatory powers, as well as transparency standards. The traditional approach to legitimacy in the Netherlands has been the corporatist system of balanced representation of the social partners, but the erosion of this system suggests that there is a need to re-examine the openness of these activities to public scrutiny. This is especially important to the extent that professional bodies retain regulatory functions, and as regional and international market openness develops. Guidelines would improve the transparency of the industry and professional boards, enhance their accountability to government and the public, including consumers, and maintain market openness.

Another transparency initiative that would improve co-ordination, RIA, and consultation is the publication of a plan of important upcoming regulation. Several countries have found such plans useful in improving the capacity of the public to comment, and the capacity of the administration to co-ordinate actions. This would be consistent with initiatives currently in train in the Netherlands to improve access to existing legislation (through electronic means) and could be integrated with the publication of a summary of proposed primary legislation which is currently undertaken.

- *Better co-ordinate regulatory reform and regulatory quality initiatives.*

There are opportunities to improve the degree of co-ordination between the various regulatory quality assurance and regulatory reform initiatives being undertaken in the Netherlands. Improved co-ordination would be particularly beneficial between RIA and consultation processes, between the Ministry of Justice' legislative quality assurance work (including the Directives on Legislation and the scrutiny of Bills process) and RIA and between RIA and programmes aimed at using regulatory alternatives.

There does not seem to be a clear relationship, or co-ordination, between the Directives on legislation, and the Ministry of Justice assessment of legislative quality, on the one hand, and the RIA process and role of the Ministry of Economic Affairs on the other. This appears to reflect the historically dominant role of the Ministry of Justice in regard to legislative policy and a consequent tendency to view legislative quality as primarily a technical legal concept, rather than as one which has a distinct, and possibly paramount, economics/public policy aspect.

Addressing this issue appears to require a role for the Ministry of Economic Affairs that is more integrated with the Ministry of Justice' work on legislative quality assessment. In addition, formulation of legislative quality guidelines covering economic and public policy aspects of quality that are distinct from (though co-ordinated with) a more streamlined set of "legal" guidelines should be considered. Here again there is a need for a strong co-operative relationship between the two ministries. Moreover, the latter guidelines should be presented in the context of a strengthened set of RIA requirements. Finally, the very limited time available to the Ministry of Justice to review draft legislation and initiate dialogue with the proposing ministry – often less than two weeks – undermines this quality check. Process changes which extended this review period, and began it earlier in the process, are likely to be a positive move, notwithstanding concern over the length of the legislative process.

### 5.4. Managing regulatory reform

The most important determinant of the scope and pace of further reform is the attitude of the general public. The emphasis in the MDW programme on a "*new balance between protection and dynamism*"[36] must be preserved if reform is to enjoy continued support in a citizenry that places high value on safety,

health, environmental quality, and social equity, as well as a consensual approach to public policy. Evaluation of the impacts of reform and communication with the public and all major stakeholders with respect to the short and long-term effects of action and non-action, and on the distribution of costs and benefits, will be increasingly important to further progress.

The example of building support in the main consumer organisation is illustrative. The Consumentenbond was concerned that the MDW approach seemed to focus unduly on business interests, with no clear definition of consumer benefits and a lack of transparency in the process. Yet actions on competition law and shop trading hours were seen as having the clear potential for major consumer benefits. As the programme progressed, the government invited participation and was seen as responsive to the consumer association's principles for reform, focusing on the need for clear consumer benefit, an emphasis on re-regulation rather than deregulation and a view of deregulation as an instrument rather than a goal in itself. As a result, the consumer movement is now a supporter of MDW, seeing it as consistent with its overall emphasis on maximising consumer choice in all markets.

While there are continuing concerns about a move to competition in areas such as public transport, health care and social security, views on the most visible reform – the extension of shop hours – are largely favourable. At this juncture, it seems that fears about the effects of reform on levels of protection have not been borne out, but continued reform will proceed faster and more deeply if reformers take concrete steps to demonstrate that protection has been maintained. As the Consumentenbond has noted "Strong markets need strong governments".[37]

There is a positive view of the likely longer term benefits to business from increased competition in the provision of business services, as well as the additional opportunities which will arise from changes to government provision of commercial services (including both withdrawal from the field and the adoption of "competitive neutrality" principles). Like the consumer association, business initially saw MDW as lacking in transparency and opportunities for input by stakeholders, but these concerns have apparently been largely allayed. Significantly, there is support for the more targeted approach of MDW, which is seen as more effective than earlier attempts at a "global" approach to reform.

The kinds of reforms suggested above will be limited in impact if the regulatory activities of other levels of government are not brought into the process. Much of the national regulation of the Netherlands originates in fact at the level of the European Union. Much of the implementation of regulation is in the hands of municipal and other subnational levels of government. Regulatory reform is no longer, if it ever was, an activity that national governments can carry out in isolation. A programme of co-ordination of reforms spanning these levels of government can help protect and extend the benefits of reform in the future. In particular, using information generated through RIA as an input into EU decision-making processes, assisted by the fact that the European Commission is currently looking at means of improving its RIA performance, is potentially of great value.

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# BACKGROUND REPORT ON THE ROLE OF COMPETITION POLICY IN REGULATORY REFORM*

* This report was principally prepared by **Michael Wise** in the Directorate for Financial and Fiscal Affairs of the OECD. It has benefited from extensive comments provided by colleagues throughout the OECD Secretariat, by the Government of the Netherlands, and by Member countries as part of the peer review process. This report was peer reviewed in June 1998 in the OECD's Competition Law and Policy Committee.

# TABLE OF CONTENTS

## Executive Summary

## Background Report on The Role of Competition Policy in Regulatory Reform

Is competition policy sufficiently integrated into the general policy framework for regulation? Competition policy is central to regulatory reform, because (as the background report on Governement Capacity to Assure High Quality Regulation shows) its principles and analysis provide a benchmark for assessing the quality of economic and social regulations, as well as motivate the application of the laws that protect competition. Moreover, as regulatory reform stimulates structural change, vigorous enforcement of competition policy is needed to prevent private market abuses from reversing the benefits of reform. A complement to competition enforcement is competition advocacy, the promotion of competitive, market principles in policy and regulatory processes. This report addresses two basic questions. First, is the Netherlands' conception of competition policy, which will depend on its own history and culture, adequate to support pro-competitive reform? Second, do national institutions have the right tools to promote competition policy effectively? That is, are the competition laws and enforcement structures sufficient to prevent or correct collusion, monopoly, and unfair practices, now and after reform? And can competition law and policy institutions encourage reform?

The government's reform program has been based on competition principles. Coinciding with the program to review and improve regulation, enforcement of the law about competition was strengthened. These efforts culminated in the adoption as of January 1998 of a completely new competition statute, modelled on the competition law of the EU, and a new enforcement structure, designed to be independent and thus to reinforce the new approach, of prohibiting private arrangements that prevent competition. These new institutions face important tests of how the different values incorporated in the conception of "competition principles" will be applied in practice. The new enforcement agency must demonstrate its competence and independence, by applying sound, consistent competition policies without unnecessary compromise to accommodate other interests. The Ministry of Economic Affairs has been a strong advocate of drawing a better balance between desirable competition and necessary regulation. But the Netherlands has long promoted co-operation, and competition law has been weak as a result. Other interests have resisted change, successfully defending existing arrangements in some cases. Challenges remain, as the Netherlands continues to debate the relative importance of competition policy and other regulatory goals.

## 1. THE CONCEPTS OF COMPETITION POLICY IN THE NETHERLANDS: FOUNDATIONS AND CONTEXT

Netherlands competition policy and law have evolved substantially over the past decade. The competition law passed in 1958, but its apparent prohibitions of price agreements, of market sharing agreements, and of collusive tendering were notoriously unenforced, leading to the Netherlands' increasing reputation as tolerant of cartels. A 1992 article claimed that some forty per cent of the important cartel cases in EC competition enforcement were Dutch.[1] The government's register of cartels – maintained in secret – contained some 245 agreements to divide markets and nearly 270 agreements to fix prices, in addition to nearly 50 exclusive dealing agreements and over 200 agreements to control competition in distribution.[2] The combination of lax enforcement with widespread private agreements and private and public regulations controlling entry and administering prices meant that the intensity of market competition was relatively low in many sectors, particularly those sheltered from import competition. Meanwhile, the European Commission brought many cases against market-wide bid-rigging and exclusive dealing agreements that prevented competition in Dutch industries.[3]

By the late 1980s, though, the government began moving to correct the situation. Enforcement of the existing competition law was stepped up and extended to cover liberal professions and informal agreements. Measures were adopted for greater transparency, improved supervisory powers and stronger sanctions. The government tried to ban the most harmful kinds of cartel behaviour, as far as that was possible under the existing legal structure. As of July 1993, price fixing was officially prohibited, marking something of a revolution in Netherlands competition policy. In 1994, market division and collusive tendering were banned, too. At about the same time, it was decided to move toward adopting a completely new legislative basis for competition policy, based on the law of the EU. In addition to these actions already underway to strengthen the basic institutions of competition law enforcement, the new cabinet in 1994 included competition policy as a fundamental element of its MDW regulatory reform programme, described above in the background report on Government Capacity to Assure High Quality

### Box 1. Competition policy's roles in regulatory reform

In addition to the threshold, general issue, whether regulatory policy is **consistent** with the conception and purpose of competition policy, there are four particular ways in which competition policy and regulatory problems interact:

- Regulation can **contradict** competition policy. Regulations may have encouraged, or even required, conduct or conditions that would otherwise be in violation of the competition law. For example, regulations may have permitted price co-ordination, prevented advertising or other avenues of competition, or required territorial market division. When such regulations are changed or removed, firms affected must change their habits and expectations.
- Regulation can **replace** competition policy. Especially where monopoly has appeared inevitable, regulation may try to control market power directly, by setting prices and controlling entry and access. Changes in technology and other institutions may lead to reconsideration of the basic premise in support of regulation, that competition policy and institutions would be inadequate to the task of preventing monopoly and the exercise of market power.
- Regulation can **reproduce** competition policy. Rules and regulators may have tried to prevent co-ordination or abuse in an industry, just as competition policy does. For example, regulations may set standards of fair competition or tendering rules to ensure competitive bidding. Different regulators may apply different standards, though, and changes in regulatory institutions may reveal that seemingly duplicate policies may have led to different practical outcomes.
- Regulation can **use** competition policy methods. Instruments to achieve regulatory objectives can be designed to take advantage of market incentives and competitive dynamics. Co-ordination may be necessary, to ensure that these instruments work as intended in the context of competition law requirements.

Regulation. The new competition law became effective and the new enforcement agency, the *Nederlandse Mededingingsautoriteit* (NMa) came into official being on 1 January 1998. This report will concentrate on these recent, fundamental changes in the explicit structure and basis for competition policy in the Netherlands, to integrate the discussion of how competition policy has affected regulatory reform.

The Netherlands' principal reason for strengthening competition policy, reflected in the law's very form, is to respond to the increasing interconnection of national economies by harmonising with European law and the competition rules applicable under the Treaty of Rome. This desire is motivated in turn by recognition that national prosperity requires the capacity to respond to international developments. European unification, the adaptation of Member States to EU law, the globalisation of economic relations, the speed of technological development, the progressive removal of remaining obstacles to trade, and the availability of advanced communications technologies all signal that a national economy cannot be separated from the international one. These general reasons to look outward apply equally to competition policy. Tolerating domestic cartels and concentrations of economic power ultimately handicaps a nation's ability to adjust and contributes to structural problems of employment and low growth. Enterprises operating in sheltered sectors that are unable to respond to intensified competitive relationships as markets open will lose ground to imports or foreign direct investments, and will lose out on opportunities in the wider market too. As Europe has integrated, and as European institutions have demonstrated the importance and the value of promoting and protecting competition, the Netherlands has found it necessary, and expedient, to follow that direction too.

The second principal motivation for the Netherlands' competition policy is a generalisation of the first one: the encouragement of dynamic market responsiveness. The government's statements about the foundation of the Netherlands' new competition policy emphasise dynamic factors: "Healthy competition between companies trains an economy, as it were, in adaptive capacities."[4] Impairing static and dynamic efficiency, by restricting free pricing, production, or market access, not only raises prices and costs, but also, and perhaps more importantly, prevents the market mechanism from serving its functions of steering resources and of stimulating and disciplining producers, and reduces quality consciousness and innovation. Government statements point to economic research showing that consumers and producers can potentially gain hundreds of millions of guilders by strengthening competitive forces. But the principal arguments offered in favour of the change in approach are not based on that kind of quantification, but on the importance of dynamic adaptability.

In all these senses, tougher competition is said to lead to greater consumer welfare. This formulation does not use "consumer welfare" in the sense of economic static equilibrium analysis, of maximising consumer surplus or total surplus. Rather, it emphasises that the interests against which policy is to be measured are those of ultimate consumers, as informed participants in an open market economy. Fairness, growth, and the protection of small and medium sized enterprises are said not to be explicit goals of competition policy in the Netherlands, although they may result from application of an efficiency-based policy. The stated purposes of the Netherlands' competition policy are consistent with the purposes usually ascribed to the competition policy of the EU, which the Netherlands law is intended to model. There too, the emphasis is on aspects of process and dynamic efficiency, rather than static equilibrium welfare effects.[5]

Concerns about fairness, distribution, and small business may not be explicit factors in the government's announced policy, but they are strong elements of the Netherlands' social traditions. Indeed, it is these concerns that probably delayed the implementation of effective competition policy for so many years. Small and medium sized businesses believed they benefited from the regime of registered cartels, and their resistance resulted in several compromises in the final legislation. These include an explicit "bagatelle" exemption in the law and special block exemptions for aspects of distribution. The principal impetus for the reform evidently came from other directions. Larger businesses with greater experience of foreign trade have become increasingly aware of the need to adapt to changing conditions in a larger context, and have learned to be more comfortable dealing with competition policies through their experience in other jurisdictions. These interests have backed the reforms. In addition, the major consumer organisation, *Consumentenbond*, has also supported the reform program and the

adoption of the new law and enforcement structure. And the Social and Economic Council (SER) supported the approach of new law, although it expressed some reservations about aspects of it.

Although competition has been vigorous for products exposed to international trade, and firms engaged at that scale have become efficient and competitive, the story is different for products and services traded only in local markets. Yet for perhaps three-fourths of Dutch consumers' purchases, it is domestic, not international, competition that determines prices and quality. Much of the economy, in sectors such as construction, utilities, financial transactions, transport, retail trade, and consumer and professional services, has been insulated from imports. Because the market is small, competition in some of these sectors (where there are some economies of scale) must be achieved among a relatively small number of undertakings or providers. This will be a challenge, because it is in these sectors that the national tradition of protecting established positions is strongest. Continuity, tradition, and alliances have taken priority over individual risk-taking and entrepreneurship. The new competition policy is a central element of a "cultural turnaround" that the Netherlands must make to ensure its economic health in the new global market economy.

### Box 2. Regulation by industry and trade organisations

In the Netherlands, co-operation is institutionalised. In addition to associations of professionals with substantial legally delegated powers of self-regulation, in the Netherlands there are comparable self-regulatory institutions for agriculture, trade, and smaller service businesses. These 38 "statutory industrial organisation bodies", or PBOs, are composed of representatives of business organisations and unions. There are two kinds of PBOs, "commodity boards", which combine the vertically-related stages of production, and "industry boards", which are horizontally organised at a particular level, such as retail or wholesale trade. PBOs are most significant in sectors dominated by small businesses, though some of them, particularly the commodity boards, include very large firms. The major commodity boards include those for horticulture, agriculture, livestock, meat and eggs, dairy products, and beverages. Industrial boards include those for retail trade, wholesale trade in agricultural products, hotels and restaurants, retail-level services (such as opticians and bakeries), and house painters. The half-million enterprises covered by PBOs employ about a quarter of the people working in industry, trade and agriculture. The total number of PBOs has declined. Thirty years ago, there were 55; more consolidation is planned, so that 18 will remain by 2000.

Authorised by the Industrial Organisation Act of 1950, the PBOs have legal powers to regulate and promote their sectors' interests. On request of the government they can implement national and European policies in their sectors, too. PBOs "tax" their sectors to pay for their operations, which can include research projects, vocational training, and promotional campaigns. Their regulations are subject to the approval of the SER and the government (and the EU, if they might interfere with EU policies). Most of the mandatory regulations are found in the commodity boards. These typically cover quality control and inspection, disease prevention, additives, import-export processes, and consumer information. In addition, PBO regulations may implement national and EU policies. For example, some PBOs are responsible for implementation of EU agricultural regulations.

The Industrial Organisation Act requires that PBOs not impede fair competition. PBOs are not to authorise enterprises to enter, expand, or exit the market, and are not to regulate prices. The Act was recently reviewed, in part to ensure the protection of competition. Under the current law, the SER is responsible for authorising PBOs and plays the most active role in supervising their regulations. The government proposed that in the future the minister would be charged with that supervision and that he would judge those regulations according to the principles on which the Competition Act is based. The legislature rejected this proposal, and also defeated a proposed amendment to have the NMa share responsibility. Existing PBO regulations are also being reviewed, and it is still the intention that SER judge PBO regulation according to the principles of the Competition Act. But the effectiveness of competition policy here is at best unclear. NMa could still refuse to exempt agreements among PBO members that might violate the competition law's prohibitions, and it could take enforcement action against prohibited agreements that are not exempted. But it would be more consistent to have the agency charged with expertise in interpreting and applying the Competition Act also participate in applying it to such actions as the formation of these organisations and their regulations.

The competition law reform is complementary to (although not itself part of) the "MDW" deregulation programme. Achieving a balance between necessary regulation and desirable competition will be a particular challenge in the Netherlands, because of the country's long tradition of self-regulatory structures. Some of the motivations for this "private regulation" are plausible and defensible, and some of the results appear likely to be efficient: co-operating to overcome market failures and magnify the effects of research and development, realising economies of scale, and protecting reputation and quality through protecting trademarks, curbing deceptive marketing, and redressing consumer complaints. It is less clear, though that such self-regulation is a useful way to "counteract the excesses of unrestrained competition, as the Ministry of Economic Affairs has suggested in trying to describe the proper role for industry self-regulation.[6] Even if the "excesses" refer only to deceptive or unscrupulous marketing practices or monopolising tactics, it would be more prudent and effective to leave their correction to public enforcement and redress actions by consumers and customers, for a purpose phrased this broadly could also include protecting competitors against vigorous, efficient, innovative competition. The supposed benefits of privately imposed restraints on competition are rarely justified by the costs they impose, and the problems are not self-correcting because the costs are typically borne by unorganised consumers.[7]

The new statute, the new agency, and the overall reform program clearly embody an intention to move toward a regime of stronger competition, enforced by law and embodied in more market-oriented regulation. But success is not assured. Many of the Netherlands' collective, corporatist structures of self-regulation can be expected to resist change. Different parties' understandings of what reform means conflict, with some concerned that the new law does too little to protect competitors from each other or to protect incumbent firms against "unfair" competition from unfamiliar sources. If these interests feel that the competition law does not protect them, or that the change in focus threatens their interests, they will support continued anti-competitive regulation.

## 2. THE SUBSTANTIVE TOOL-KIT: CONTENT OF THE COMPETITION LAW

If regulatory reform is to yield its full benefits, the competition law must be effective in protecting the public interest in markets where regulatory reform enhances the scope for competition. The legal criteria and available sanctions under the competition laws should be able to address competition problems that may have been required or encouraged by old regulations that no longer apply, or problems that will appear as regulatory structures change. The general competition law can then constitute a substantive foundation for reform based on market principles. In the Netherlands a major element of the regulatory reform process is the creation of a strong competition law. Thus it is particularly important to assess how well that aspiration is likely to succeed. Will the new law provide a strong foundation for a different kind of competition policy than the Netherlands has seen in the past? Or can it be manipulated in ways that duplicate the old practices? And if so, is there a political will to resist that course?

The new competition law is said to be based on the "nature", not just the "legal form", of relationships.[8] Yet the most obvious change in the new law is formal. The "abuse" system of the old act has been replaced by a system of prohibitions matching the EU approach. Under the previous system, the enforcer, which in the Netherlands was the Ministry of Economic Affairs, had to demonstrate in each particular case that an agreement or action violated the law's standard. The enforcer had the burden of proof, and it was difficult to establish principles or rules that would apply in different, but similar, cases. A prohibition system reverses the burden, so that it is the company that must demonstrate that agreements or behaviour which correspond to the law's prohibitions nonetheless do *not* conflict with the applicable standard. The major difference between the "abuse" and the "prohibition" approaches is administrative, in the differing presumptions and assignments of burden. The same results can be reached under either, if the basic substantive criteria are the same. Debate and discussion about the change in the law has made much of this shift in administrative basis. Perhaps that emphasis serves a valuable function of symbolising determination to change a fundamental attitude about competition policy. But the difference in formal administrative method, by itself, is unlikely to have such a profound effect.

Changes in underlying substantive standards and in enforcement competence are as important as the administrative shift from "abuse" to "prohibition". The old competition law's fundamental substantive criterion was simply the "general interest", which by itself is nearly devoid of content or guidance for

### Box 3. The competition policy toolkit

General competition laws usually address the problems of monopoly power in three formal settings: relationships and agreements among otherwise independent firms, actions by a single firm, and structural combinations of independent firms. The first category, **agreements,** is often subdivided for analytic purposes into two groups: "horizontal" agreements among firms that do the same things, and "vertical" agreements among firms at different stages of production or distribution. The second category is termed **"monopolisation"** in some laws, and "abuse of dominant position" in others; the legal systems that use different labels have developed somewhat different approaches to the problem of single-firm economic power. The third category, often called **"mergers"** or "concentrations", usually includes other kinds of structural combination, such as share or asset acquisitions, joint ventures, cross-shareholdings and interlocking directorates.

**Agreements** may permit the group of firms acting together to achieve some of the attributes of monopoly, of raising prices, limiting output, and preventing entry or innovation. The most troublesome horizontal agreements are those that prevent rivalry about the fundamental dynamics of market competition, price and output. Most contemporary competition laws treat naked agreements to fix prices, limit output, rig bids, or divide markets very harshly. To enforce such agreements, competitors may also agree on tactics to prevent new competition or to discipline firms that do not go along; thus, the laws also try to prevent and punish boycotts. Horizontal co-operation on other issues, such as product standards, research, and quality, may also affect competition, but whether the effect is positive or negative can depend on market conditions. Thus, most laws deal with these other kinds of agreement by assessing a larger range of possible benefits and harms, or by trying to design more detailed rules to identify and exempt beneficial conduct.

**Vertical agreements** try to control aspects of distribution. The reasons for concern are the same – that the agreements might lead to increased prices, lower quantity (or poorer quality), or prevention of entry and innovation. Because the competitive effects of vertical agreements can be more complex than those of horizontal agreements, the legal treatment of different kinds of vertical agreements varies even more than for horizontal agreements. One basic type of agreement is resale price maintenance: vertical agreements can control minimum, or maximum, prices. In some settings, the result can be to curb market abuses by distributors; in others, though, it can be to duplicate or enforce a horizontal cartel. Agreements granting exclusive dealing rights or territories can encourage greater effort to sell the supplier's product, or they can protect distributors from competition or prevent entry by other suppliers. Franchising often involves a complex of vertical agreements with potential competitive significance: a franchise agreement may contain provisions about competition within geographic territories, about exclusive dealing for supplies, and about rights to intellectual property such as trademarks.

**Abuse of dominance** or **monopolisation** are categories that are concerned principally with the conduct and circumstances of individual firms. A true monopoly, which faces no competition or threat of competition, will charge higher prices and produce less or lower quality output. It may also be less likely to introduce more efficient methods or innovative products. Laws against monopolisation are typically aimed at exclusionary tactics by which firms might try to obtain or protect monopoly positions. Laws against abuse of dominance address the same issues, and may also try to address the actual exercise of market power. For example under some abuse of dominance laws, charging unreasonably high prices can be a violation of the law.

**Merger control** tries to prevent the creation, through corporate restructurings, of undertakings that will have the incentive and ability to exercise market power. In some cases, the test of legality is derived from the laws about dominance or restraints; in others, there is a separate test phrased in terms of likely effect on competition generally. The analytic process applied typically calls for characterising the products that compete, the firms that might offer competition, and the relative shares and strategic importance of those firms with respect to the product markets. An important factor is the likelihood of new entry and the existence of effective barriers to new entry. Most systems apply some form of market share test, either to guide further investigation or as a presumption about legality. Mergers in unusually concentrated markets, or that create firms with unusually high market shares, are usually thought more likely to affect competition. And most systems specify procedures for pre-notification to enforcement authorities in advance of larger, more important transactions, and special processes for expedited investigation, so problems can be identified and resolved before the restructuring is actually undertaken.

decisions. Determining whether conduct was contrary to the general interest required consultation with other ministries, which were often sympathetic to aspects of the general interest other than competition policy. Every case could become an occasion for fundamental debate about the relative importance of competition policy, and for many years competition policy evidently lost. The new law's use of explicit prohibitions changes the terms and scope of that debate, in a way that could make enforcement more efficient. It is still possible to claim that conduct which the law prohibits should nonetheless be permitted; however, the law begins with a presumption that the conduct is illegal. The law limits, to some extent, the kinds of factors that can be considered in the balance. And it creates a new, less politicised process for considering them. Even in these respects, though, the differences between the old system and the new one are not profound. The criteria under the new law for granting exemptions for agreements could embrace most of what the old law considered under the "general interest". What matters most are the clarity of the conceptions and goals underlying competition policy, and the strength of the political and social forces supporting, or opposing, that policy. A pattern of generous exemptions under a prohibition system could reach the same practical result as a pattern of generous balancing-test applications under an abuse system.

### Box 4. The EU competition law toolkit

The Dutch law follows closely the basic elements of competition law that have developed under the Treaty of Rome:

- **Agreements:** Article 85 prohibits agreements that have the effect or intent of preventing, restricting, or distorting competition. The term "agreement" is understood broadly, so that the prohibition extends to concerted actions and other arrangements that fall short of formal contracts enforceable at civil law. Some prohibited agreements are identified explicitly: direct or indirect fixing of prices or trading conditions, limitation or control of production, markets, investment, or technical development; sharing of markets or suppliers, discrimination that places trading parties at a competitive disadvantage, and tying or imposing non-germane conditions under contracts. And decisions have further clarified the scope of Article 85's coverage. Joint purchasing has been permitted (in some market conditions) because of resulting efficiencies, but joint selling usually has been forbidden because it amounts to a cartel. All forms of agreements to divide markets and control prices, including profit pooling and mark-up agreements and private "fair trade practice" rules, are rejected. Exchange of price information is permitted only after time has passed, and only if the exchange does not permit identification of particular enterprises. Exclusionary devices like aggregate rebate cartels are disallowed, even if they make some allowance for dealings with third parties.
- **Exemptions:** An agreement that would otherwise be prohibited may nonetheless be permitted, if it improves production or distribution or promotes technical or economic progress and allows consumers a fair share of the benefit, imposes only such restrictions as are indispensable to attaining the beneficial objectives, and does not permit the elimination of competition for a substantial part of the products in question. Exemptions may be granted in response to particular case-by-case applications. In addition, there are generally applicable "block" exemptions, which specify conditions or criteria for permitted agreements, including clauses that either may or may not appear in agreements (the "white lists" and "black lists"). Any agreement that meets those conditions is exempt, without need for particular application. Some of the most important exemptions apply to types of vertical relationships, including exclusive distribution, exclusive purchasing, and franchising.
- **Abuse of dominance:** Article 86 prohibits the abuse of a dominant position, and lists some acts that would be considered abuse of dominance: imposing unfair purchase or selling prices or trading conditions (either directly or indirectly), limiting production, markets, or technological development in ways that harm consumers, discrimination that places trading parties at a competitive disadvantage, and imposing non-germane contract conditions. In the presence of dominance, many types of conduct that disadvantage other parties in the market might be considered abuse. Dominance is often presumed at market shares over 50 per cent, and may be found at lower levels depending on other factors. The prohibition can extend to abuse by several firms acting together, even if no single firm had such a high market share itself.

Applying a prohibition system introduces a new set of potential problems. A prohibition system supports, and leads naturally to, a system of detailed rules. These rules would not usually include explicitly any element of judgement about actual competitive effect, since the administrative reason for a prohibition system is to shift the burden to the parties, to demonstrate that their conduct does not have such an effect. To deal with the kinds of conduct whose effect may be ambiguous, rules under a prohibition system may become highly complex and formalistic. And despite the desire for efficiency, applying them may actually be time-consuming, as the decision-maker must parse the rules' fine distinctions when dealing with parties applying for waivers. Much of the doctrine of EU competition law is contained in the detailed structure of exemptions and their attendant prescriptions and prohibitions. Their application is sometimes delayed or obscured by time-consuming and non-transparent processes. That is, the competition law about restrictive business practices can itself look much like other kinds of regulation, with their commonly encountered problems of fair and cost-effective implementation.

The attraction of a prohibition system is the clarity and certainty of explicit rules. The risk is that those rules will become formalistic and overbroad. The challenge is to develop and apply a system of general prohibitions that still permits sensitivity to case-by-case variations in actual economic and competitive significance

### 2.1. Horizontal agreements: rules to prevent anti-competition co-ordination, including that fostered by regulation

Article 6 of the new competition law parallels Article 85 of the Treaty of Rome in its treatment of all kinds of agreements. The NMa intends to look to the EU institutions for substantive guidance in interpreting it. The Dutch law, unlike the Treaty of Rome, does not include in the text the examples of particular kinds of prohibited agreements. The list of prohibitions was omitted from the statute and placed instead in the regulations. To the extent the Dutch law is interpreted consistently with the EU's guiding principles, it is likely to be a strong tool for preventing and correcting the most serious horizontally-imposed constraints.

General prohibition in Article 6 is subject to conditions and procedures for exemptions and dispensations[9] which also parallel the EU system. The Dutch law borrows or incorporates all of the EU block exemptions for general types of agreement or restraint, exemptions for particular sectors, and exemptions for particular agreements.[10] Incorporation is "dynamic"; that is, Dutch law incorporates not just those exemptions already adopted but also those that will be adopted in the future.[11] The grounds for exemption or dispensation under the Dutch law are the same as under Article 85 of the Treaty.[12] The result of using the EU prohibition-exemption system is that formal criteria, rather than case-by-case economic analysis, will usually determine legality, except in the consideration of individual dispensation applications.

The new Dutch law permitted parties to apply for dispensation for agreements that were already in existence. NMa was flooded with dispensation requests – over a thousand – at the deadline, 1 April 1998.[13] These filings afford a small degree of protection to these already-existing agreements, which remain legal until NMa can act on the individual applications (unless they would have been illegal under the superseded Economic Competition Act).[14] A large proportion appear to be simply "insurance" filings, submitted out of an abundance of caution for agreements that would obviously not be prohibited. Many are in retail and construction, two sectors subject to specific exemptions under the new law. Some represent continuation of existing controversies under the new procedures. How the new agency applies the new law to these old problems will be a critical test of its seriousness and effectiveness.

Even under the previous abuse system, the government had introduced *per se* rules about price fixing and market division. A "general invalidation of horizontal price maintenance" was adopted in 1993.[15] In important substantive details and procedures, including the coverage, basic prohibition and provisions for exemptions based on national and EU legislation and for *de minimis* cases, this 1993 decree foreshadowed the new law. About 50 applications for dispensation were submitted even before it went

into effect.[16] Similar decrees tried to ban market sharing and collusive tendering. But only one final judgement was reached under the "abuse" system, while about five additional cases were concluded with settlements. The fact that some continuing controversies were not resolved, but instead postponed by granting explicit exemptions in the course of approving the new law, measures the depth of the cultural aversion to competition, and thus the magnitude of the cultural revolution that is required. A prime example is newspapers, which asked for dispensation for their horizontal and vertical price-fixing and received a formal exemption (for a term of years) when the new law was passed.

Applying the old law generally required a consultation within the government. Not all of those consultations prevented action. Recently, at least, other ministries have gone along with more vigorous competition policy. Dispensation was denied for a national market-division for emergency tow truck operators, because the worthy goals of clearing wrecks quickly and preventing pileups could be accomplished by less anti-competitive means. Dispensation was denied in a number of cases involving "private regulation": a minimum price agreement among ship brokers, a pharmacists' association's price-fixing agreement for non-prescription drugs, an insurance agents' agreement about remuneration, a football league agreement to control its members' broadcast rights, a pharmacist association's rules controlling soliciting or accepting new patients, and a joint boycott by associations of estate agents and notaries.[17]

Despite these occasional successes, the need to establish intra-government consensus in each case about the "general interest" no doubt made it difficult to apply the old law effectively to many horizontal agreements in sectors subject to reform or in efforts to promote reform. It is clearly anticipated that the new law will help overcome those problems. It has evidently been taken seriously enough to bring some old cartels out into the open. Some of the April applications are for existing agreements that the decree under the old law had prohibited, but for which no application for dispensation had previously been submitted.

### 2.2. Vertical agreements: rules to prevent anti-competitive arrangements in supply and distribution, including those fostered by regulation

Like the EU law on which it is based, the text of the competition law draws no distinction between horizontal and vertical agreements. Vertical agreements affecting competition are in principle prohibited. The Ministry and NMa recognise that the law must permit some scope to admit restraints that are not harmful, and that indeed may be essential for useful co-operation, efficient distribution, or marketing support. The principal means for attempting to do so is incorporation of the EU exemptions scheme, supplemented by additional general exemptions specific to the Netherlands.

The "prohibition" policy for vertical price agreements, like that for horizontal ones, was foreshadowed in efforts to apply the old law more strictly. The 1993 order also expanded the prohibition of resale price maintenance. An application for dispensation for bicycles was rejected; however, one for books and music was allowed, and has even been extended for seven years under the new law. Rules about credit card surcharges were treated as horizontal, that is, an industry-wide arrangement to impose a vertical constraint. "Shelf-space" agreements for magazines, which claimed space based on share but then increased the allowed margin for more space, were rejected because they excluded competitors. Demonstrating sensitivity to context and effect, no problem was found with Apple Computer's selective distribution system. And demonstrating sensitivity to the concerns of small business, an investigation was opened in response to a complaint from MKB-Nederland (the association of small and medium-sized enterprise) about the identical unit charges applied by BeaNet, an alliance of Dutch banks, for Chipknip (chipcard) transactions.[18]

The new law's relatively stringent treatment of vertical agreements, although consistent with long-standing EU law, is inconsistent with the trend in many OECD countries toward case-by-case, economically-based analysis for vertical restraints (except for minimum resale price maintenance), and away from detailed, formal rules.[19] Now the European Commission too is considering whether to modify its own practice in order to pay closer attention to actual economic effects in different settings, perhaps by introducing market share tests for some kinds of conduct.[20] Many Dutch businesses advocated continuing to treat vertical agreements under the "abuse" principle, so that anti-competitive effect would have

to be demonstrated in each particular case. But the government resisted that approach, in part because it wanted to adopt consistent, across-the-board rules and thus emphasise the magnitude of the cultural shift involved in changing the law. Strict treatment seems to follow from a definition of "competition" that necessarily entails independent action. Under that conception, any constraint on independent action, even one agreed to voluntarily by vertically related parties who do not compete against each other in a particular market, might be considered a constraint on competition and thus presumptively prohibited. And strict treatment may also be a particular response to the Netherlands' history of industry-wide vertical exclusive dealing agreements used to prevent competition.

The government's defence of its policy included three generalisations about economic effects of vertical agreements. The first is that all vertical agreements have a "horizontal" effect because they restrict an entity's ability to respond to actions by its horizontal competitors. But whether that effect is desirable or not depends on what the horizontal competitors are doing. If they are attempting to agree on prices or output, a vertical constraint that prevents going along with them could be pro-competitive. If they are unable to agree among themselves, but their suppliers "require" them all to agree, then the vertical constraint could accomplish a horizontal, monopolising effect. That is, whether the vertical restraint actually impairs beneficial market competition depends on case-by-case assessment of the actual market conditions in which it appears. The second is that vertical agreements often implement horizontal constraints by other means. This may well have been true in the Netherlands, if many upstream suppliers entered agreements with their distributors that were similar, not only within each supplier's distribution system, but across brands as well, and the effect was to prevent horizontal competition at either or both levels. If so, then enforcement efficiency may call for a stricter presumption, at least until that historical pattern is completely corrected. But it would be better, to avoid unnecessarily impairing innocuous arrangements, to limit the presumption to the clearest market-foreclosure settings. And even that may require basing the legal test on market share analysis, not just on the legal form of the agreements' terms. The third is that intra-brand competition is as important as competition between branded products because vertical "alliances" are increasing. The argument seems to be that, because these alliances do not compete with each other, competition within them must be preserved. But the degree and competitive importance of brand differentiation is also an empirical matter, and it is doubtful that strong presumptions about it are either necessary or efficient bases for enforcement rules.

The treatment of vertical agreements tests, in two ways, the relationship between the purposes of competition policy and the commitment to regulatory reform. Careful attention to the actual competitive effects of vertical arrangements is a necessary part of a market-oriented reform effort. Poorly designed regulations sometimes prohibit efficient vertical arrangements, or require inefficient ones, and such rules should be identified and corrected. But trying to do this through a prohibition-based competition policy can itself lead to elaborate, detailed, prescriptive regulation (or to obscure and difficult legal doctrines). At a minimum, the complexity can impose compliance burdens. Moreover, the doctrines may end up preventing or inhibiting desirable and efficient agreements. Rules based on legal formality will inevitably miss economically important factors. Thoroughgoing attention to the goals of reform counsels a close inquiry, whether the costs imposed justify the benefits of this particular kind of "regulation". The abuse system of applying the old law, whatever its other defects, had the capacity to be sensitive to actual economic effects. Deliberate adoption of a general-prohibition administrative basis for the new law should not be allowed to undermine that sensitivity to case-by-case variations in economically relevant contexts.

The principal motivation of the new Dutch law is to respond to globalisation, and the principal means is by harmonising its law with the European one. Consistency is surely desirable, so that businesses are not caught between confusing and potentially inconsistent demands. That factor, and the possibility that the Netherlands' history of unusually exclusionary vertical relationships demands an unusually clear presumption against them, could support treating them as prohibited. But if the EU too moves toward a more modern treatment of vertical restraints, the Dutch law might profit from the intention to attend to EU practice as it evolves.

### 2.3. Abuse of dominance: rules to prevent or remedy market power, especially arising from reform-related restructuring

The new law's text about abuse of dominance[21] is based on Article 86 of the Treaty of Rome. Like the law about agreements, it omits the Treaty's detailed examples. The definition of "dominance" is taken from the decisions of the European Court of Justice. Applications to the problem of network access would also derive from EU principles. An undertaking that has a dominant position because of its control over the network is obliged to offer objective, transparent, reasonable and non-discriminatory prices and other conditions for network access. (Under the EU's telecommunications reform legislation, there is a presumption of market power, and thus a requirement to afford access, at a market share of 25 per cent.)

The new competition law may play only a limited role in ensuring access and restructuring traditionally regulated network monopolies. Proposals to handle these problems exclusively through general competition law have been rejected in favour of some form of continuing sector-specific regulation. An illustration is the cable TV industry. In early 1997 the Minister of Economic Affairs, along with the Ministers of Transport and Public Works and of Education, Culture and Sciences, proposed that controversies about access to cable systems be handled under the new general competition law. The temporary supervisory powers of the Media Commissariat over this issue would expire, leaving NMa with the responsibility, to be exercised in consultation with the Media Commissariat and the Independent Post and Telecommunications Authority (OPTA).[22] But in April 1998 Parliament rejected this solution, and instead assigned the task to OPTA, without specifying standards for performing it. In other aspects of telecommunications and in electric power, too, it appears that important competition-policy elements of restructuring and reform will not be done under the general competition law, but under other, sector-specific regulatory bodies and laws. Evidently, NMa is to be consulted and have some approval authority about the sectoral regulators' general rules and interpretations of competition policy terms, but it will have no role in particular decisions or applications. The division of responsibility is to be reviewed in four years, but in the meantime the competition agency's participation in actions with significant competitive impacts is likely to be limited. This delay would be unfortunate, if sectoral regulators interpret and apply competition principles in ways that are more consistent with the sector's historic way of doing business, rather than in ways that encourage the rapid development of more competitive alternatives.

### 2.4. Mergers: rules to prevent competition problems arising from corporate restructuring, including responses to regulatory change

Merger policy too parallels the EU standards and methods, seeking to prevent proposed mergers that are likely to create or strengthen a position of economic dominance which would significantly restrict free and fair competition on some or all of the Dutch market. The substantive prohibition is based on dominance, so mergers that increase the likelihood of concerted action must be analysed as though the result were collective dominance. EU policy and jurisprudence are used for the purposes of delineating the market. As under the EU Merger Regulation, there is a mandatory pre-merger filing, jurisdiction is determined by reference to turnover, and there is a two stage investigation, subject to deadlines for decision, during which the parties cannot consummate the transaction. The notification thresholds are at the average level for Member countries with premerger notification programs: combined aggregate world-wide turnover of at least 250 million guilders (approximately US$125 million), and annual turnover within the Netherlands of at least 30 million guilders (approximately US$15 million) for at least two of the undertakings involved. Mergers involving foreign firms are also subject to review provided these thresholds are met. NMa has four weeks from the filing date to decide whether the concentration can create or strengthen a dominant position, and if so, to require the parties to apply for a licence. NMa must then make a final decision within an additional thirteen weeks after receiving the application for a licence. If NMa refuses to grant a licence, the parties have four weeks to apply to the Minister of Economic Affairs, in effect appealing NMa's refusal. Failure to notify or to apply for a licence if required voids the transaction and subjects the parties to administrative fines of up to 50 000 guilders (approximately US$25 000) or periodic penalty payments. In its first three months of

operation, NMa received about 34 merger filings, issued 17 phase-one clearance decisions, and issued 2 decisions requesting an application for a licence. This pace is about double what had been expected.

In principle, NMa will decide based only on the strength of competition-based considerations, in accordance with the model specified by the EU Merger Regulation. In practice, EU decisions will sometimes also consider efficiency gains, and NMa might do so as well. The most significant source of balancing against other policy values, though, will be the Ministerial appeal. The Minister of Economic Affairs can grant a license, after discussions with the Council of Ministers, if there are significant public interests at stake. Such public interest considerations could include the companies' (international) competitive position and anticipated cost savings. The Minister of Economic Affairs has often stated that the overruling option is to be used with restraint, because the aim is to not base merger evaluations on political value judgements. Since the new law took effect, no such occasion has arisen. One threatened conflict was fortunately avoided, but the circumstances undercut the Ministry's announced intentions about NMa's independence. The Ministry of Economic Affairs supported a major combination of electric generating firms, before NMa indicated it had concerns about the merger's competitive effects by requiring the parties to apply for a license. But the parties could not reach final agreement on their deal and thus called it off. By signalling its support, the Ministry presented NMa with a serious dilemma. If NMa had ultimately issued the license, the new agency would have been suspected of yielding to the Ministry's implied threat of overruling it. If NMa had denied the licence and then the Ministry had granted it, the process would have demonstrated that legal criteria were less important than political ones. Either outcome would have compromised NMa's apparent independence of enforcement authority. By calling off the transaction, the parties denied NMa and the Ministry the chance to demonstrate that independence by permitting NMa's denial of a license to stand.

### 2.5. Competitor protection: relationship to rules of "unfair competition"

There is no general prohibition of unfair competition in the Dutch competition act, although predatory pricing and disparagement might be prohibited if they amounted to abuse of a dominant position. But other laws establish traditional competitor-protection rules of unfair competition that could support private civil actions, and business or professional organisations have internal rules about unfair competition. As elsewhere, some of these, such as constraints on pricing and advertising competition, are likely to be inconsistent with the general competition law. Part of the program to strengthen enforcement under the old law was to challenge some of these constraints. NMa should continue such actions. Some business groups wanted a new competition law that could be used to challenge what they consider unfair acts by their rivals. Most of these groups comprise smaller and medium sized firms that feel they lack the resources to compete directly with larger, more efficient rivals. So far, the only obvious concession to these concerns is the government's promise that the new agency will "closely monitor potential predatory pricing through sales below cost-price". It is encouraging that neither the government nor NMa has indicated any intention to do more than monitor closely.

Also of interest in the context of regulatory reform is the concern about unfair competition from government entities and privatised firms, not only through abuse of dominance but also through other advantages derived from the undertaking's relationship to the government, such as financial or tax advantages, cross-subsidies, or the power to regulate its competitors. A blue-ribbon commission examined this problem and made recommendations about dealing with it, discussed below in Section 4.1.

### 2.6. Consumer protection: consistency with competition law and policy

The Dutch reform programme is based on consumer interests. This treatment of competition and consumer policies as mutually supportive provides a strong, integrating political base for reform. It has attracted useful allies: the major national consumer organisation, *Consumentenbond*, has supported the general reform efforts and the adoption of the new competition law. Government descriptions of its consumer policy emphasise that it is not so much about protecting consumers, as it is about enabling them to participate in the market as independent actors. Competition policy aims at ensuring that companies do not restrict or distort competition and thus limit consumer choice, while consumer policy

aims at ensuring that consumers, by free and informed choices, can spur companies to improve their performance and respond to demand.

The Dutch government recognises the importance of using competition- and market-based instruments of regulation in pursuing consumer policies. Some intervention in the market may be necessary to protect such interests as public health and safety, and intervention may also improve information-based market problems such as consumers' lack of information (as in financial services) or relative inability to assess quality (as in professional or legal services). Interventions, where required, should not unnecessarily restrict competition or encumber suppliers, because in the long run such constraints will harm consumers too. The Netherlands relies strongly on self-regulation by industry bodies and groups such as the PBOs to implement consumer policies. Especially if consumer interests are represented in the process as well, parties in the market may well find better solutions for market imperfections than government regulatory intervention. Examples of such instruments are the system of private arbitration boards for consumer dispute settlement, the determination of the content of general contract terms under the Civil Code in several market sectors in consultation with Consumentenbond, and more recently the conclusion of a code of conduct for the insurance sector, also in consultation with Consumentenbond. But it is important for the government to prevent self-regulation to protect consumer interests from shading into self-regulation to protect producer and competitor interests.

This integrated consumer and competition policy position is in some tension with the Netherlands' neighbours. Most Dutch consumer legislation is based on legislation of the EU. The Netherlands has nonetheless advocated an integrated, market-based approach in the field of EU consumer policy, though not always successfully. At a 1997 debate about the principles of consumer policy held during the Dutch presidency of the EU Consumer Council, only a few Member States supported the Dutch approach. A majority emphasised that an active policy aimed at protecting consumers in areas such as health, safety, food, financial services and advertising and at increasing market transparency and consumer information is still very much necessary.

## 3. INSTITUTIONAL TOOLS: ENFORCEMENT IN SUPPORT OF REGULATORY REFORM

Reform of economic regulation can be less beneficial or even harmful if the competition authority does not act vigorously to prevent abuses in developing markets. The new authority has every intention of demonstrating its effectiveness promptly. Much depends on its success.

### 3.1. Competition policy institutions

Implementation of the new Competition Act is entrusted to the new Dutch Competition Authority (NMa), an entity within, but separated from, the Ministry of Economic Affairs. Decisional authority rests in NMa's Director General. NMa itself is a law enforcement agency, and does not deal with competition policy, regulatory issues, or relationships with other ministries, functions which are the responsibility of the Ministry of Economic Affairs. The Dutch have chosen to assign top priority to establishing the clarity of the new prohibition system, entrusting it to a self-consciously independent enforcer whose discretion is limited to the parameters set by law and who will be perceived as outside the political process.

To embody its intended independence, NMa has its own legal powers, separate from the Ministry of which it formally a part. Other features of its organisation encourage or support that independence. NMa is located in a separate building, at a considerable distance from the Ministry. The first Director General, Mr. A.W. Kist, is an experienced lawyer who did not come from the Ministry. The Minister's responsibility is formally preserved, and Parliament can call the Minister to account for that responsibility. The Minister lacks the legal power to take decisions himself, so, to make the responsibility meaningful, the Minister has the power to issue instructions to the Director General, either in general or in particular cases. But the Minister has stated that the power is to be exercised with "maximum restraint". The intention is that NMa's status resemble the Bundeskartellamt, in that ministerial oversight, though theoretically possible, is (virtually) never actually implemented.[23] To maintain distance and encourage

actual independence, the relationship between the Minister and NMa is to be transparent. If the Minister of Economic Affairs does issue instructions to grant an exemption in a specific individual case, that instruction must be in writing and included in the dossier. In merger cases, NMa is responsible only for applying the law. If other, political considerations come into play, the Minister must do that personally and publicly. This separation and publicity may prove an effective check; at least, it will expose Ministerial intervention to political and public oversight. The Minister has recently announced the intention to give NMa the independent status of a "ZBO", comparable to OPTA's, as soon as possible, which will mean that the minister would lose the power to issue instructions in individual cases.

NMa's independence should be promoted further by authorising it to engage in advocacy about policy proposals and other decisions that affect competition. Advocacy demonstrates that the enforcer speaks and thus acts as an independent, expert body. Advice about competitive impacts of legislation or regulation can gain credibility if it comes from a relatively non-political source that is knowledgeable about how markets work. A reason often given for separating advocacy from enforcement is that the credibility of law enforcement positions would suffer from connection to the policy process. But this is only a risk if it appears that the enforcer's policy views were subject to political pressure, and that the pressure affected its enforcement decisions. Denying NMa any advocacy role choice was not essential in order to establish its independence; on the contrary, an advocacy role should re-enforce it. Of course, there is a risk that NMa's positions will differ from the government's. But that difference would demonstrate, and represent, the desired independence. And in any event, there is already concern that effective independence will be difficult to establish while NMa remains formally within the Ministry, regardless of the intentions of both the Ministry and NMa and regardless of whether it has advocacy responsibilities. In the debates over the assignment of responsibility for competition regulation in sectors being restructured, some have argued, persuasively, that a truly independent sectoral regulator would be preferable to the competition agency because the latter, still formally within the Ministry and subject to Ministerial instruction, is not independent enough.

### 3.2. Competition law enforcement

Application and enforcement now uses administrative methods. By contrast, the decrees under the old law prohibiting price agreements and market division were enforced by criminal processes. Much of the process involves reviewing and deciding about applications for exemption or dispensation from the law's prohibitions. In gathering necessary information, NMa has the usual enforcement powers available under Dutch administrative law. NMa can respond to complaints or act on its own initiative. Its officials can require answers to written or oral questions and carry out inspections of premises and documents, with or without previous notice. If access is refused, NMa can obtain the assistance of the police to enter. The powers are subject to generally applicable limits, as well. Use of investigative powers is subject to the general civil law principle of proportionality. Investigating officials may not demand entry to private houses nor take possession of a firm's documents without permission (though they can take copies). Privileged documents are protected from disclosure, and there is a right against self-incrimination, for undertakings as well as individuals. Failure to co-operate with an investigation or provide requested information can lead to administrative fines up to 10 000 guilders or periodic penalty payments. Inaccurate or incomplete information when notifying or requesting a licence for a concentration can lead to administrative fines up to 50 000 guilders. Fines for substantive violations can be up to NLG 1 million or 10 per cent of turnover (whichever is higher). The agency is young, so its uses of these powers have not all been tested yet.

There has so far been little opportunity for NMa itself to demonstrate the virtue of decisional predictability. Additional sources of guidance, while companies wait for NMa to establish a record of its own, come from the EU's standards, on which national standards are based, and the decisions and procedures of the EU and the European Court of Justice. If a company disagrees with a decision, it can submit a formal objection to the Director General of NMa. If the objection is turned down, the company can appeal to the district court, and from there to the Companies Appeals Court.

Deadlines in the Competition Act are intended to ensure expedition. The initial decision whether to require a license application for a mergert must be made within four weeks of the initial notice, and

Box 5. **Enforcement powers in the Netherlands**

**Does the agency have the power to take action on its own initiative?** NMa, like most Member country agencies (19), has power to issue prohibitory orders on its own initiative. Unlike the agencies in about half of Member countries, it cannot assess financial penalties directly, but instead must go to court.

**Does the agency publish its decisions and the reasons for them?** Like virtually all Member country enforcement agencies, NMa publishes its decisions.

**Are the agency's decisions subject to substantive review and correction by a court?** All Member country competition agencies must defend their actions in court if necessary.

**Can private parties also bring their own suits about competition issues?** Some kind of privately initiated suit about competition issues is possible in nearly all Member countries. One reason for shifting the basis of the competition law to a prohibition system was to support civil actions under it; before, such actions could only be brought based on violations of the EC competition rules.

the final decision, within thirteen weeks after the license application. An application for an exemption from the prohibition of Article 6 must be decided within four months. Within ten weeks of receiving the request, however, the Director General can extend the term for a further four months. The total time taken to consider such a request should therefore not exceed eight months. If NMa does not respond within this term, the request is regarded as having been rejected. The applicant can then appeal. This allocation of presumption emphasises the law's prohibitory intention, perhaps too much so. Because the consequence of inaction is simply to transfer decision responsibility to another body, it may also fail to encourage prompt decisions. Nonetheless, the new NMa Director General has made it a priority to respond to applications in a timely fashion. If NMa succeeds in doing so, that will reduce concern about this presumption's potential for misuse.

### 3.3. Other enforcement methods

The principal additional source of competition policy affecting the Netherlands is, of course, the EU. One advantage of bringing Dutch law into line with EU law, besides simplicity and transparency for Dutch business, will be that consistency should encourage the EU to leave local competition issues to local settlement, as called for by the principle of subsidiarity.[24] Merger enforcement illustrates this principle. Because the Netherlands lacked a merger law of its own at the time, the European Commission was asked in 1997 to investigate Blokker's proposed take-over of the Dutch branches of Toys 'R Us. The request was authorised by the EU Merger Regulation's so-called "Dutch clause",[25] letting the Commission take action, on request, against a merger within one Member State's territory. The Commission declared the acquisition incompatible with the common European market and ordered Blokker to sell the Toys 'R Us branches to an independent third party. The EU competition rules also contain the converse of the "Dutch clause", namely the "German clause"[26] under which the Commission can refer a proposed merger to the qualified Member State authorities. Now that the Netherlands has its own law, it has already invoked this clause to investigate the proposed combination of the KBB and Vendex retail chains.

Private actions under national law procedures will also be available now that the law is based on prohibition. The nullity of prohibited competition agreements and of concentrations that violate reporting and license requirements can support civil actions for damages or an injunction. The possibility of auxiliary private action could lead to more effective enforcement, by bringing additional resources to the task. But permitting private actions is not without risk. Parties can sometimes invoke formal rules in court proceedings in order to prevent competition, rather than protect it, unless judges have the discretion to reject claims based on lack of actual anti-competitive effect in the particular circumstances. If judges do have that discretion, then they become important sources of competition policy. Private actions based on the Treaty of Rome prohibitions are infrequent, but one has already been filed, and

decided, under the new Dutch law. It demonstrates how quickly the courts can move. In emergency cases such as this, the president of a district court can rule in summary proceedings within about five weeks. It also shows the court's willingness to defer to the new competition enforcer about substantive issues. An insurer arranged for a discount program from opticians; in response, another optical firm advertised that its prices were better than those under its competitors' discount program. The insurer sued to stop the comparative advertising, and the optical firm counter-sued, claiming that the deal on discounts amounted to price-fixing. In a preliminary proceeding, the court granted both claims, provisionally, pending a decision by NMa about the competition issue.

An alternative to private, independent action is private initiative at the enforcement agency. A private party has some rights of complaint, participation and appeal in the administrative law process. An aggrieved party may ask NMa to take action. The Director General must explain his decision, including a decision not to act. A dissatisfied complainant may file an objection to the decision with the Director General, who must respond within eight weeks, after having heard an advisory commission. If the Director General decides not to revoke his decision, the complainant may appeal to the courts. Here again, this process makes it likely that the courts will have an important influence on competition policy.

### 3.4. International trade issues in competition policy and enforcement

The Dutch law takes a generally neutral approach to problems raised by foreign trade and by foreign firm participation in the Dutch market and administrative process. Restrictive practices that obstruct access to a relevant market in the Netherlands may violate the law, regardless of whether the obstruction affects Dutch firms or foreign firms. Merger control also applies regardless of the nationality of the parties or the locus of the transaction, if the turnover thresholds are met. These include one based on turnover in the Dutch market, so foreign firms are unlikely to be affected unless they or their prospective merger partners are already present in the market. Issues such as market openness, foreign supply or likelihood of entry into the Dutch market are taken into account when defining the geographic scope of the relevant market and analysing the effects on competition, under the EU analytic methods that the Dutch are using. The Dutch Competition Act only applies to effects in the Dutch market, though. Dutch firms that are affected by restrictive practices abroad cannot invoke the Dutch competition rules. And Dutch firms engaged in restrictive practices outside the Netherlands (that do not affect a market in the Netherlands) cannot be subject to sanction under the Dutch Competition Act.

The Competition Act applies to all firms engaged in economic activities in the Netherlands, even if they are established abroad. Enforcement abroad will be difficult, of course, in the absence of legal powers to counter obstruction of investigations and refusal to pay fines. In general NMa will address a foreign firm's subsidiaries or branches established in the Netherlands. If effective enforcement by NMa is not possible the case can be transferred to another national competition authority or to the European Commission. The competition law permits the exchange of information with other competition authorities, if the information is used to apply competition rules (and with other parts of the Dutch government, where their responsibilities are related to competition policy).[27] The new agency's processes for co-operation with other competition authorities are still being established, and it is not yet a party to any formal co-operation agreements. In these respects NMa should follow the 1995 OECD Council Recommendations on notification and co-ordination, and the increasing adoption of formal co-operation agreements among national enforcers.

Foreign firms receive national treatment, that is, they have the same rights as domestic ones to apply for exemptions or licenses, to submit views or objections concerning applications by others, to bring complaints to NMa, to take action if dissatisfied with how those complaints are resolved, or to bring private actions. Under the old law, some foreign firms had complained that wholesale-level exclusive-dealing cartels had excluded them from access to the Dutch market. NMa is prepared to examine similar claims under the new law. The law does contain a procedural provision that could be especially useful to foreign firms, either as respondents or as complainants. Where presentations are made orally, a party who does not adequately understand Dutch may request an interpreter, and the Director General is to ensure that one is appointed (unless the request appears unreasonable).[28]

Box 6. **International co-operation agreements**

Eight Member countries have entered one or more formal agreements to co-operate in competition enforcement matters: Australia, Canada, Czech Republic, Hungary, Korea, New Zealand, Poland, and the US. And the EC has done so as well.

### 3.5. Agency resources, actions, and implied priorities

The top priority for the new enforcement agency is to establish itself as an institution, supporting the "cultural transformation" toward greater reliance on competitive markets. The new Director General believes it is most important that NMa be, and appear to be, independent in its decision-making. NMa must show the public how the law can be applied in its interest, by bringing a significant and successful enforcement action early in its history. At the same time, he believes it very important to establish a reputation for professionalism, by meeting deadlines, responding promptly to inquiries, and avoiding bureaucratic disputes and embarrassments. Because it is so important to establish substantive credibility, it is unlikely that NMa will take on cases that attempt to test the outer limits of doctrine. Rather, it will be focusing now on cases it can uphold against a challenge in court, and targeting places where problems are likely to be found, such as services and other sectors that had been sheltered from international competition. Together, these steps appear to comprise an optimal strategy for a new enforcement agency.

NMa's staff of about 70 consists of one staff section and three operational sections. The largest, the Investigations, Supervision and Dispensations (OTO) section, is chiefly responsible for supervising compliance and investigating possible violations. OTO handles applications for dispensation and investigates prohibited competition agreements and abuses of dominant positions. The second section, Control of Concentrations (CoCo), with about a dozen staff, is responsible for determining whether concentrations require licenses. The third section, Decisions, Objections and Appeals (BBB), is responsible for handling objections and issuing decisions about breaches of sanctions, and it represents NMa's Director General in appeal hearings.

The change in law has been accompanied by a very large increase in resources. NMa's staffing level represents more than three times the number of staff that had been assigned to the predecessor office in the Ministry. The budget has also increased substantially, although the exact increase is unclear (the data in the following table for the years 1993-1997 are not strictly comparable with the 1998 data for NMa). The personnel for NMa represent about 0.01 per cent of total government employment, and the

Table 1. **Resources devoted to competition enforcement by the Ministry of Economic Affairs (1993-1997) and the Dutch Competition Authority (NMa) (1998)**

| | Competition policy person-years[1] | Competition policy expenditures[2] |
|---|---|---|
| 1998 | 73 | 20.0 |
| 1997 | 18 | 6.9 |
| 1996 | 19 | 10.7 |
| 1995 | 20 | 8.3 |
| 1994 | 20 | 9.8 |
| 1993 | 20 | n.a. |

1. *Person-years*: number of persons employed in competition policy departments of directorate for Market Policy including 8 persons employed in the Economic Investigations Agency (ECD).
2. *Expenditure (in million guilders)*: for 1993-1997, expenditures for research and subsidies from the Market Policy directorate, excluding rent, wages and other costs, but including work on other policies besides competition policy. For 1998, the total budgeted expenditures for the Dutch Competition Authority, including rent, wages, and overhead.

*Source:* Responses to the OECD Review Questionnaire.

budget, about 0.006 per cent of non-defence government spending. (By comparison, in the US, personnel in the federal government competition enforcement agencies account for about 0.08 per cent of employment, and the budgets for about 0.015 per cent of spending). Commitment of these significant additional resources demonstrates that the intention to strengthen enforcement is indeed serious.

Table 2. **Trends in competition policy actions**

| | | Horizontal agreements | Vertical agreements | Abuse of dominance | Other[1, 3] |
|---|---|---|---|---|---|
| **1996-1997:** | Investigations or matters opened | 116 | 2 | 14 | 68 |
| | Sanctions or orders sought[2] | 31 | 1 | 3 | |
| | Pecuniary sanctions imposed | | | | 1 |
| **1995-1996:** | Investigations or matters opened | 70 | 2 | 3 | 68 |
| | Sanctions or orders sought[2] | 29 | | 1 | 1 |
| | Pecuniary sanctions imposed | | | | 1 |
| **1994-1995:** | Investigations or matters opened | 41 | | 2 | 72 |
| | Sanctions or orders sought[2] | 3 | | 1 | |
| | Pecuniary sanctions imposed | | | | |
| **1993-1994:** | Investigations or matters opened | 59 | | | 74 |
| | Sanctions or orders sought[2] | 20 | | | |
| | Pecuniary sanctions imposed | | | | |

1. *Matters opened*: "other" column includes investigations done by the Economic Investigations Agency (ECD), estimated at between 25 and 50 matters during 1993-1997.
2. *Sanctions or orders sought*: decisions taken, negative as well as positive.
3. *Other*: cases with a combination of the above elements.

*Source:* Annual reports on competition policy; Responses to the OECD Review Questionnaire.

The level of activity had increased markedly even before the new law became effective, with nearly twice as many matters opened in the latest period, compared to those preceding. Most of these matters are evidently requests for exemption or dispensation from the ban on agreements and bid rigging.

One reason relatively few matters concluded with a decision under the old system was that companies often corrected their conduct before the decision issued. Under the old law, that meant there was no longer any basis for action. And the main reason very few sanctions were imposed was that the principal means of enforcing the ban on horizontal agreements was through the criminal law. Prosecutors brought few cases. The proportion of cases leading to orders and sanctions should increase, now that the law is being enforced through administrative procedures.

## 4. THE LIMITS OF COMPETITION POLICY FOR REGULATORY REFORM

### 4.1. Economy-wide exemptions or special treatments

Two general exemptions will be relevant to regulatory reform. First is a broad "regulatory authorisation" exemption that casts doubt on the strength of the commitment to reform based on competition principles. The law's prohibitions do not apply to agreements that are subject to the approval of an administrative agency pursuant to other legislation, that could be declared invalid or prohibited by another agency, or that have arisen pursuant to another statutory requirement.[29] Competition law thus stands at the end of the priority line. Even the mere potential for conflict, such as the possibility that another agency could approve, or even disapprove, the conduct, could mean that the competition law does not apply. The exemption is set to lapse in 2003, and in the meantime debate will continue about how to set policy priorities. The kinds of potentially conflicting regulatory requirements that are under review include minimum price setting for natural gas, mandatory co-operation for small utility companies, government-set landing fees and passenger transport rates, mandatory agreements for regional broadcasts, and mandatory agreements about surface mineral production. Even without the statutory

exemption, a court might not accord the competition law precedence over a potentially conflicting regulatory system. But if that indeed happened, the decision could presumably be corrected by legislation. The blanket exemption decides all those conflicts in advance, and decides them contrary to the interests of competition policy. The competition law will be more effective as a tool for reform when this exemption expires – if it is indeed allowed to expire. Facing the deadline, the various ministries may focus on the need to set out the relative priorities more explicitly. Or they may find it expedient just to extend the exemption when the deadline comes, leaving competition policy as the lowest priority in the event of conflict. That would be a major impediment to using the competition law in the reform process.

Second, there is a partial exemption from all aspects of the law for entities or associations entrusted with services of general economic interest, that is, utilities and other public service undertakings.[30] This exemption parallels precisely the similar exemption in Article 90 of the Treaty of Rome. These entities are technically subject to the prohibitions against agreements and abuse of dominance, but not if applying the prohibition would prevent performance of their special tasks. This exemption extends not only to these entities themselves, but to agreements to which one of them is a party or decisions by associations of which it is a member, at least to the extent of the necessity. Much will depend on how broadly NMa interprets the possibility of "preventing" the performance of their tasks. The parallel to the EU, and the intention to follow EU principles and interpretations, suggest that this exemption will be applied narrowly, because Article 90 has generally been applied narrowly. So far, there has been no occasion to apply the exemption under the new Dutch law. But the likelihood of keeping the exemption narrow is supported by the enforcement record under the old law. The old law was applicable to publicly owned or managed enterprises, and proceedings or complaints were lodged against exclusive dealing and excessive charges in cable television, excessive tariffs for water supply, distortion of competition by energy distributors, and unfair cross-subsidisation of package delivery by the postal service.[31]

Unfair competition from entities related to the government has received considerable attention. It was the subject of a 1997 report by a panel of appointed experts, the "Market and Government" Working Group (also known as the Cohen Working Group after its Chairman, Professor M.J. Cohen). The report outlines a conceptual framework for (semi-) government organisations that compete in the market with private companies. These entities, which the report termed "organisations with exclusive or special market rights", or OEMs, often enjoy an exclusive position, such as a monopoly, granted in order to perform their public tasks. The report concluded that market operations by these entities are undesirable, because it is not possible to prevent distortion of competition. The report concluded that in principle, commercial activities should be segregated and divested, although some exceptions to this rule of structural separation might be admitted: commercial activities intrinsic to the OEM's public duties, commercial activities relating to scientific research, activities to support maintaining a minimum physical plant capacity, or a situation of competition for the public duties, such as for electricity distribution. Even for these exceptions, the report called for rules of conduct applied by a new, independent supervisory authority to achieve equal competitive conditions. The Cabinet endorsed the report's main points and took some preparatory steps toward implementation. Several particular OEMs were set for investigation, anticipating the issuance of new regulations or instructions for them. A list of all central government OEMs was made, as a basis for further investigation and reform. Suggestions include making competitive OEM commercial activities liable for corporation tax, and discussions between the government and municipal and provincial authorities about how the report's conceptual framework could be applied. The Cohen report is well-conceived and, despite its reticence about making particular policy recommendations, usefully concrete. But implementation has been only tentative; stronger action is needed.

Small and medium sized enterprises receive special treatment. Smaller firms are not usually thought likely to exercise market power, although in small enough markets, small enterprises may effectively agree to eliminate competition. Nevertheless, the competition law includes an explicit, partial exemption for small businesses.[32] The "bagatelle" exemption covers agreements among small groups (eight or fewer participants) of limited economic importance (total turnover of 10 million guilders for sales, or two million for services). Although the agreements are not subject to the general prohibition, NMa may order small firms to terminate them in particular cases if they are found to have a significant

detrimental effect on competition. The somewhat similar *de minimis* provision of EU competition policy is a statement of intention that is not binding on the courts. The Netherlands put the exemption into the text of the law, in part to satisfy objections and demands from small business groups that the exemption be even larger. The exemption's stated purpose is to remove the threat of prohibition and legal nullity from agreements which are of minor significance. But whether their competitive impact is minor depends on the market setting, not just on the firms' size. The partial exemption raises the costs of enforcement against anti-competitive actions by smaller firms. It would be unfortunate if the cost of enforcement meant that the law had to tolerate retail price fixing among small enterprises in small towns. Here a more tightly drawn exemption, which continued to prohibit horizontal price fixing and market division while according "abuse" treatment to other kinds of agreements, might strike a better cost-benefit balance. Perhaps that result can be reached without amending the law by establishing such a rule *de facto* through a targeted enforcement programme.

Some other provisions of the law might particularly benefit small and medium sized enterprises, although they do not amount to exemption or special treatment. For example, some forms of agreement that may particularly benefit small and medium sized enterprises are not considered to be prohibited, or are exempted, under standard EU applications and exemptions. Joint market research, joint research and development, joint customer and repair services, joint advertising and joint quality certificates are not regarded as competitive restraints and thus are not prohibited at all. Block exemptions that may be important for small and medium sized enterprises include the block exemption for franchise agreements and the supplementary Dutch block exemptions for price co-ordination in conjunction with joint advertising and certain exclusive selling agreements. These aim to permit useful forms of co-operation between independent retailers, to strengthen their position against chain organisations. They are not exclusively meant for small and medium sized undertakings, but many of those undertakings may profit from them.

Box 7. **Scope of competition policy**

**Is there an exemption from liability under the general competition law for conduct that is required or authorised by other government authority?** Like most Member countries (15 out of the 27 reporting), the Netherlands provides an exemption from the general competition law for conduct under the jurisdiction of another regulation or government authority.

**Does the general competition law apply to public enterprises?** Like all Member countries except the US and Portugal, the Netherlands' general competition law is applicable to the commercial actions of public enterprises; however, this potential application is narrowed some by the exemption, following the EC's doctrines, for utilities and other public service undertakings.

**Is there an exemption, in law or enforcement policy, for small and medium sized enterprises?** The Netherlands, like its neighbours Belgium, France, and Germany, provides a form of special treatment, more lenient treatment for certain agreements among small businesses.

### 4.2. Sector-specific exclusions, rules and exemptions

The government has announced sound principles to guide the relationship between sector-specific regulation and competition policy, which would make competition rules effective tools for reform. It has been less successful implementing these principles. In January 1998 the Dutch Cabinet issued a statement about how to supervise privatised utilities to prevent fragmented oversight and inconsistent application of competition concepts. In particular, the Cabinet called for restraint in the introduction of specific competition rules. If the desired result can be realised through the general competition regime, no sector-specific rules are necessary. If sector-specific rules are unavoidable, the Cabinet held that they should overlap as little as possible with the general competition regime, their relationship to

general rules should be defined as accurately as possible, they should be reassessed periodically, and they should be applied in co-ordination with NMa. If NMa itself or a chamber within NMa is not directly responsible, then the sectoral supervisor must reach agreement with NMa on how the general competition terms in sector-specific rules should be interpreted in individual cases.

In practice, however, the framework being put in place appears to fall short of these sound principles. Parliament has assigned exclusive responsibility for access to cable TV networks to the new telecommunication regulator, OPTA, rather than to NMa. OPTA will also evidently have exclusive responsibility for telecommunications. While competition law will still apply in principle, actions taken pursuant to OPTA's authority or potential authority could be exempt under Article 16. In electric power transmission, there will be a hybrid organisation structure, with a sector regulatory office or responsibility located within NMa.

In addition, the framework being established does not contain an explicit "forbearance" procedure to reassess, on the basis of whether incumbents have substantial market power, the need for sector specific regulation. In telecommunications, the regulator plans to follow the suggestion of the EU and apply a "25 per cent" rule of thumb (although OPTA retains the discretion not to find market power at higher share levels, and even to find market power at lower ones). Unless applied with sensitivity, such a blanket rule raises a significant danger that regulation will be maintained where the marginal benefit of its safeguards is outweighed by the costs, of administrative burden, reduced pricing flexibility, and diminished incentive to innovate and bring new products to the market. Rather than a general rule of thumb set at such a low market share level, it would be better to establish a process for assessing market power, and thus the need for continued regulation, in specific fact situations.

The framework does provide that sector-specific rules are to be applied in consultation with NMa. The sectoral agencies and NMa are trying to establish a good continuing working relationship. Still, it is unclear that mechanisms for consultation can assure an accurate and consistent correspondence between sectoral regulatory decisions and generally applicable competition concepts. Where, as in telecommunications, NMa itself or a chamber within NMa is not directly responsible, it would be best if the sectoral supervisor could reach agreement with NMa on how general competition terms in sector specific rules should be interpreted in individual cases. As it stands, there is no independent assessment of the competition policy implications or effects. If the sector-specific regulator is charged with making the ultimate decision based on public interest grounds, it is important that an independent competition assessment be undertaken, so that the extent of the regulator's deviation from competition policy principles is transparent.

Several special sectoral rules and exemptions were maintained or established in connection with the enactment of the new law. These evidently represent political compromises. The block exemptions for franchising and certain joint actions in retailing and distribution may reassure those sectors about the exact bounds of permissible behaviour in their competition with integrated chain operations. But others, notably those for publishing, are more problematic. That is, it is doubtful that no less anti-competitive way could be found to achieve the policy goal. Several of the items noted below are not technically exemptions from the competition law, but are potentially anti-competitive regulations or requirements that are beyond the reach of the law because of the "regulatory authorisation" exemption. There may be others whose potential conflict is not as obvious. Between now and when the general "regulatory authorisation" exemption is set to expire, potential conflicts will be subject to further study, in a effort to resolve them so the general exemption can be eliminated. That study, though necessary, addresses only the most obvious way that regulation and competition policy might conflict. A more comprehensive review should examine systematically the competitive implications of all existing legislation. Such a study, similar to that undertaken in connection with reform in Australia, would be concerned not just to identify and correct clear conflicts between competition law and other regulatory requirements, but also laws and regulations that unnecessarily impair competition in other ways.

**Retail maximum resale price maintenance:** A group exemption applies to two types of agreements between chains of independent small retailers and their members: maximum price-fixing agreements during short-term advertisement campaigns, and minimum purchase requirements. (Chains of

independent small retailers that are also subject to the EU competition rules cannot take advantage of this exemption.) The exemption is subject to several conditions, which may tend to ensure that it is employed to promote efficiency rather than to inhibit inter-firm competition. First, the firms involved must be doing business under a common formula, which includes the same requirements as "franchise" in the EU block exemption for franchise-agreements. (The Dutch exemption, unlike the EU franchise exemption, does not include or depend on exclusive territories, but only on common business format and financial relationship). Agreements on maximum prices must be in conjunction with a joint advertising campaign, limited in duration to eight weeks, and limited to at most five per cent of the assortment of goods that the franchiser, wholesaler or buying co-operative supplies to the retailers involved. Agreements that oblige a retailer to buy goods from a franchiser, wholesaler or buying co-operative require that the retailer have a financial obligation to the supplier concerning the exploitation of its undertaking, and must be limited to no more than ten years and no more than sixty per cent of the assortment of goods which the retailer offers to consumers. There is also a non-discrimination requirement: the franchiser, wholesaler or buying co-operative is not allowed to demand less favourable prices or conditions than would apply for a buyer without the obligation. The purpose of the exemptions, which are evidently used widely, is to enable chains of independent retailers to compete effectively with integrated chains, by allowing them to co-ordinate some of their marketing and to establish long-term supply relationships within franchise-like or co-operative structures. Provided that the retailers do not actually have market power in local markets, the actions that the exemption permits may indeed lead to stronger, more effective competition with integrated operations. Because of the Netherlands' history of retail-level cartels, though, the actual use and effect of these exemptions ought to be monitored carefully.

**Joint tendering:** Exemptions for contractor agreements have been complicated by a long history of controversy with the EU about bid rigging. Under the previous law, decision was deferred to the EU, which generally ruled against the Dutch constraints, failing to find any grounds for exemption. A group exemption is now part of the regime under the new law. The group exemption applies to agreements by two or more enterprises to bid jointly for a tender and, if their bid is successful, share the work and the rewards. The exemption covers only agreements for a single tender, to prevent long-term co-operation leading to *de facto* mergers. The rationale is to increase effective competition between large companies on one hand and combinations of smaller ones on the other. Here too, the rationale is plausible, but the Netherlands' history of wide-spread construction bid-rigging and rotation call for careful scrutiny of the exemption's actual effects.

**Shopping centre leases:** A block exemption permits a shopping centre operator to guarantee retailer tenants that no similar outlets will be established in the centre during its first six years of operation. Ensuring a limited degree of exclusivity can encourage investment; on the other hand, exclusive positions can be hard to dislodge, if space usage changes slowly. Despite the plausibility of the evident purpose, the history of retail cartels again suggests that its actual impact should be followed, to determine whether the exemption is serving that purpose well.

**Banking and insurance:** For now, the Minister of Finance, rather than NMa, is responsible for reviewing proposed mergers between banks and insurers. The evaluation concentrates first on solvency and second on market effect. In other respects, the competition act applies to these sectors, and the special provision about mergers is to expire in two years. There is some risk here as in other settings that the sector regulator will be more responsive to arguments about the need for large size and broad integration, and less aware of the dimension of competition policy. Already, there has been consolidation in the banking sector. If competitively troubling mergers are permitted during the transition period, their effects will be difficult to undo later.

**Newspapers:** The Minister of Economic Affairs committed to permitting horizontal price-fixing agreement about increases in subscription charges until 1 July 1999, pursuant to an agreement with the State Secretary for Education, Culture and Sciences. This will maintain an industry price-fixing agreement approved in 1997; at that time, others about introductory discounts, increases in advertising rates, and advertising agency margins were rejected. Moreover, there is also a national block exemption for resale price maintenance for news-stand sales of Dutch newspapers. This exemption is also said to be

temporary, but it will run all the way until 1 January 2003. The justification proffered for both types of price fixing is maintaining viewpoint diversity, as well as avoiding a sudden shock of changing the system before it has had time to adapt. But the new law has been in preparation for many years, so there has been plenty of time to prepare for it without too much shock. These exemptions look more like politically expedient comromises, entered to forestall editorial objections to the change in the competition policy regime.

**Book and music retailing:** In 1997, a dispensation for resale price maintenance for books and sheet music was granted, which will remain in force under the new competition act until 1 January 2005. The rationale for continuing this long-standing exemption is said to be solely the need for consistency with past concessions and representations to Parliament dating from 1985. Consistency is a weak reason to maintain a policy for over 15 years, if the policy is mistaken. An evaluation of the dispensation's costs and benefits, including the purported support for viewpoint plurality and distributional effects, is to be done from 2000 to 2005.[33] The claimed justification, of maintaining diversity, is only modestly supported, at best, in other jurisdictions' experience.[34] Mandatory resale price maintenance in France has kept a large number of publishers in business, but has also evidently kept book prices high. Countries that have a long experience without resale price maintenance for books have not reported declines in availability or number of titles. This is true even where the language base is limited. Sweden has banned resale price maintenance for more than 20 years, and book sales have not suffered, although there has been change in some distribution methods, with mail order and book clubs becoming more important.

**Electric power:** Long-term liberalisation plans continue to be implemented, as discussed further in the background report on Regulatory Reform in the Electricity Industry. The assignment of responsibility for competition-policy issues in the liberalised functions leaves competition issues in transmission in the hands of a separate regulator, DTE. That regulator will be a chamber in NMa, although it will report to the Ministry of Economic Affairs. NMa must be consulted about transmission tariffs and rules for access, and evidently may also be involved in particular decisions on those issues if necessary. Substantial overcapacity makes the Dutch market unattractive to new entrants and imports, so it is important to guard against anti-competitive effects in a domestic market. The four major domestic generating companies and the co-ordinating firm, SEP, which handled planning and pooling, at one point announced plans to merge into a single company. The combined entity may have had a dominant position within the Netherlands, and studies suggested that blocking the combination could have benefited consumers.[35] The NMa indicated it intended to take a close look at the transaction, and the parties later abandoned their plans to combine. But the near-miss experience highlights the importance of independent competition policy oversight responsibility. The issue will recur, as NMa's responsibilities concerning agreements as well as mergers may bring it into conflict with Ministry views when the industry's vertical exclusive supply agreements are submitted for dispensation under the competition law.

**Natural gas:** Although some competition issues are under the jurisdiction of NMa, the market is subject to significant economic controls, particularly concerning prices. For now, prices in this sector are subject to the Natural Gas Prices Act, under which the Minister sets a minimum price for natural gas, both domestically and for export. And under the Energy Distribution Act, if two or more legal entities are providing electricity, gas and heat to at least 5 000 of the same users, they must enter into a co-operation agreement approved by the Minister, which is exempt from the competition law. The exemption is understandable, as both of these regimes seem inconsistent with competition-based regulation. The question for regulatory policy is, why are these potentially anti-competitive systems maintained. Less anti-competitive means are probably available to raise revenue or discourage use, and to permit efficient sharing of facilities while also permitting inter-fuel competition. Both of these exemptions are being reviewed.

**Telecommunications:** Parliament has determined that this sector will be supervised by a separate, independent regulator. The competition law will still apply in principle, but actions taken pursuant to the regulator's authority or potential authority could be exempt under Article 16 of the Competition Act. There will be no independent assessment of competitive effects in particular cases. These issues are treated in more detail in the background report on Regulatory Reform in the Telecommunications Industry.

**Aviation:** Under the Aviation Act, landing fees charged by airports must be approved by the Minister, in accordance with the Chicago Aviation Treaty. This arrangement is evidently being reconsidered, as part of the process that should lead to the termination of the "regulatory authorisation" exemption.

**Transportation:** Under the Passenger Transport Act, the Minister must approve the rates and forms of transport passes. In addition, special EU rules and exemptions affect the application of the competition law here.

## 5. COMPETITION ADVOCACY FOR REGULATORY REFORM

Promoting competitive, market policies is the role of the Ministry of Economic Affairs, which has had major responsibility for the MDW program described in more detail in background report on Government Capacity to Assure High Quality Regulation. The MDW effort has included such competition-promoting projects as relaxing the 1976 Shop Hours Act, an interdepartmental study of regulation of drugs, which may offer lessons for other health care subjects, a similar examination of the liberal professions, and a government decision to introduce greater competition in public transport. Recent projects in this programme have proposed to encourage greater pricing flexibility and availability of paraprofessional services in health care, to limit to larger companies the mandatory use of an auditor for financial statements (and review the public-law status of the accountants' organisations), to limit the use of "non-compete" clauses in employment contracts, and to reduce the scope of the bailiffs' monopoly. The current, fourth tranche of the MDW programme is examining real estate agents, supervision and co-operation in collection of copyright, electronic signatures, urban regulations, business licensing, risk-bearing health insurance, and pilotage service. It is not clear how many of these other, more recent proposals are actually being implemented, or how soon. The subjects are well-chosen, and the proposed reforms are very sound from a competition policy perspective. But the programme's four year effort, taking on four or five new projects per year, had only produced four actual changes in regulation by the beginning of its fourth year. The length of time it is taking to implement these proposals implies that organized interests are still resisting change strongly. And it also reflects the inevitable realities of the Netherlands' consensus-based decision process.

NMa has no advocacy role at present. Its public outreach has been limited to publicising and explaining the new law and its own enforcement responsibilities. This limitation of its role may be rationalised as necessary to establish its enforcement competence and independence. But an active advocacy role could promote and solidify its actual and perceived independence. It could also contribute a strong and effective voice to the public debate about reform. And advocacy is a valuable complement to enforcement. Enforcement experience leads to familiarity with industry realities, which can make the enforcement body a more credible and authoritative advocate. Enforcement experience can also reveal where competition law remedies are limited and constrained by other regulatory or legal mandates. This too can focus advocacy attention on concrete problems.[36] NMa may feel that its resources are still insufficient to support advocacy, especially as it must deal with the unexpectedly large workload of merger filings and applications for dispensation. But a well-conceived, focused advocacy program can take advantage of enforcement experience to achieve significant benefits with only a modest resource commitment.

## 6. CONCLUSIONS AND RECOMMENDATIONS

### 6.1. General assessment of current strengths and weaknesses

Competition policy has been a central theme in a long-running programme of regulatory reform. The modernisation of the Netherlands' basic competition law, by harmonising it with European law and introducing merger control, is obviously an important element of that larger reform process. This continual government commitment, the clear, modern law that it has produced, and the well-designed new enforcement agency with strong leadership represent the principal strengths on which further reform

can build. The law's purposes, to encourage the economy's ability to adapt to challenge and change and to integrate more closely with EU competition policy, and are consistent with reform. And the integration of complementary consumer and competition policy principles should go far to making reform saleable to the general public. The problems of balancing sectoral regulation and competition enforcement and of eliminating problems of unfair competition from government enterprise are well understood. More broadly, aspects of the Dutch society and economy seem congenial to competition-based reform. Its markets have long been relatively open, there is a tradition of self-organising entrepreneurship, and there are many strong, independent business firms that have succeeded in the discipline of market competition.

The greatest threat to continued reform remains the strong corporatist tradition that had given the Netherlands its "cartel paradise" reputation. The institutionalisation of this structure through processes of consultation and consensus-building affords opportunities for delay and perhaps excessive compromise. On the other hand, this structure can be used to promote reform, if some of the institutional participants use it to promote competitive outcomes. Despite the government's enthusiasm for reform, there is reason to wonder whether support is very broad or deep, either in the public or among organised interests. Parliament has declined to implement some of the pro-competitive recommendations. Compromises about exemptions were necessary to get the competition law passed. The new enforcement agency's less than clear independence suggests that not all parties want to remove enforcement from the possibility of political influence by organised interests.

The Netherlands' current laws and institutions are too new to evaluate their actual performance against the substantive and process goals of reform. Their novelty constitutes both a strength and a weakness for competition policy. They embody a conscious rejection of the weakness of the old regime. But because they are untested, their real powers and intentions are unknown. Despite the change in administrative basis, the new law's substantive content and provisions for exemption and dispensation are not radically different from those available under the old one. Overall, the national commitment to competition policy approaches appears mixed and uncertain. Much will depend on strength and success of the new competition enforcement agency.

### 6.2. The dynamic view: the pace and direction of change

The direction of change is clear and appropriate. Perhaps that is because competition policy in the Netherlands had been so weak, there was only one direction left to take. Still, the progress has been considerable. The Netherlands has made a conscious effort to reject and correct what it believes were the flaws in the old system that led to its ineffectiveness. The pace, however, has been slow, though perhaps a better description might be "deliberate". After a long period of gestation, the new institutions were born in 1998. It has been about ten years since the government decided to step up enforcement, five years since formal steps were taken to ban price fixing, bid rigging, and market division, and almost as long since the government undertook a systematic program of regulatory reform.

The challenge now is for the new institutions to demonstrate that they will indeed achieve significantly different policy results than the old structures did. Further change in the basic legislation is quite unlikely for the next several years. Rather, the important benchmarks for the next few years will be in institutional performance: NMa's treatment of the host of initial dispensation requests, its success at identifying, investigating and taking action against abuses of dominance and unfilled, anti-competitive agreements, and its success at establishing its authority and independence, through court affirmations of its decisions, Ministerial abstinence from exercising its theoretical powers of instruction, and emancipation, as planned, from the Ministry itself.

More remains to be done to integrate stronger competition principles into the national regulatory system. At present, the competition authority's own role in that process is unnecessarily limited to enforcement. Moreover, because of the broad "regulatory authorisation" exemption, it will be even more limited. Another benchmark for progress in implementing broad-based competition policy will be whether this broad exemption does in fact come to an end in five years as planned, and that arrangements reached in the meantime to balance competition policy and other regulatory policies do so in a

way that limits regulation to situations of clear market failure, and clearly authorises competition policy to handle other issues for which it is competent.

### 6.3. Potential benefits and costs of further regulatory reform

Some of the tangible benefits of greater competition have begun to appear. Liberalisation of shop hours has improved several measures of competitive performance. Further improvements can be expected, as the new competition law is increasingly applied, particularly to the formerly sheltered sectors. Prices may be expected to decline in markets such as construction, health care and medical supplies, professional and other services, and local transportation. As Chapter 1 explains, prices in the Netherlands have historically been unusually rigid, so that the markets' responses must be in terms of quantity, not price. Broader application of a competition law prohibition of agreements about price may make prices more flexible, and reduce the need to make adjustments by increasing or reducing supply, or employment.

Those who have benefited from the lack of competition will likely experience at least short-term costs, thought. Where benefits have already appeared, such as in retail trade, so have these costs, in the form of greater impact on smaller retailers. Providers of professional and other services are likely to feel similar effects, challenging them to devise new, more efficient methods. Experience elsewhere suggests that the long-run employment effects of more vigorous competition policy are likely to be mixed. Employment is likely to increase, perhaps substantially, where increased competition expands the market. This has often happened in telecommunications and transport, for example. And it will decline where competition leads firms to find more efficient, less labour-intensive ways to produce the demanded output. This may be a consequence in the retail sector. The benefit of greater price flexibility may also entail a cost, as the economy may seem less resistant to inflation or deflation.

### 6.4. Policy options for consideration

The following policy options are based on the "Policy Recommendations for Regulatory Reform" set out in the 1997 *OECD Report on Regulatory Reform*.

- *Apply the new law vigorously*

A sound strategy of enforcement has been in place since the new agency began operation. The NMa's Director General intends to bring significant cases to demonstrate the law's potential and importance, including cases targeting anti-competitive codes of "unfair competition", while avoiding wasteful controversies about jurisdiction and difficult, complex, novel legal theories, and establishing a reputation for real and perceived independence and professional competence. Successful application will both yield visible benefits and build support.

- *Eliminate gaps in coverage by terminating all "temporary" exemptions on or before their planned deadlines*

The fate of these special provisions – for price fixing for newspapers and resale price maintenance for books and music, for mergers in the financial sector, and the general "regulatory authorisation" exemption – will measure the seriousness of the Netherlands' commitment. When the transition periods end, so should they.

- *Authorise NMa to engage in independent advocacy*

Advocacy complements enforcement. It can promote desirable outcomes that cannot be achieved by enforcement. It is an opportunity for both building and applying sectoral expertise. Here, as for enforcement, the new agency will be careful to choose initiatives that demonstrate benefits and build support, and will avoid controversialism that could weaken its enforcement position.

- *Implement recommendations to clarify how competition policy applies in regulated sectors and to reduce problems of unfair competition from government entities*

The 1998 Cabinet recommendations about the relative competencies of NMa and sectoral regulators are well-conceived. So far, they have been implemented imperfectly, in arrangements that do not give the competition authority clear powers concerning particular decisions that are likely to have substantial competitive effects. The recommendations call for general, not sector-specific, competition rules, and for avoiding disagreement about competition policy by giving NMa decisive authority in particular applications.

Similarly, the Cohen report provides thorough and sound analysis and recommendations about how the participation of government-related entities may distort normal market competition. What is now needed are specific plans and follow-through to implement those recommendations.

- *Undertake a systematic review of laws and regulations, including those of trade associations and institutions like the PBOs, against the principle that any restriction on competition must be clearly demonstrated to be in the public interest*

This has been the underlying task of the MDW project. Now that the experience is familiar, the review should be expanded and made more systematic, consistent with the recommendation in the *OECD Report on Regulatory Reform*. The competition review currently being carried out in Australia offers one model for such an exercise.

### 6.5. Managing regulatory reform

Despite the many signs of movement toward greater reliance on competitive institutions, economic performance still lags in the non-traded and service sectors, where application of competition policy will be least welcome but is most needed. Liberalisation of shop hours has improved several measures of competitive performance in that sector already. Sustaining and extending those benefits will depend on using the competition law to prevent backsliding, as well as on further reform of zoning and other regulations that increase costs and discourage entry. High and inflexible retail prices probably result from long-standing protection against entry, leading to comfortable tacit understandings, and sometimes overt agreements, not to compete on price. Targeting enforcement and reform on these issues must be a high priority.

The competition law's exemption for some kinds of price agreements among retailers must be applied with great care against this history, for the agreements permitted about maximum price can quickly become *de facto* agreements about minimum prices. Similarly, the law's temporary exemption for structural combinations in the financial sector is a concern, in view of the history lack of innovation in financial services in this already concentrated industry. Applying competition policy there will require some co-ordination and sensitivity to other policy interests.

Although the pace has been deliberate, the overall strategy for strengthening competition policy in the regulatory process appears sound and likely to be effective. Thorough debate has produced a modern substantive law that is tuned to Dutch concerns and political forces and an enforcement agency to match. In the near term, the challenge is to achieve concrete, successful results with these new tools and thus help consolidate the principle of reform based on competition policy.

# NOTES

1. H.W. de Jong (1992), "Het kartelparadijs: de punten van bezwaar" ["The cartel paradise: the statement of objections"], ESB, Vol. 77, n. 3878, pp. 921-927.
2. OECD (1993), *Economic Review of the Netherlands*, p. 60.
3. See, *e.g.*, Vereniging Cement Handel (OJ EC No. L 303 of 31.12.1972, p. 7); Haarden- en Kachelhandel (OJ No. L 159 of 21.6.1975, p. 22); Centraal Bureau voor de Rijwielhandel (OJ No. L 20 of 25.1.1978, p. 18), Vimpoltu-landbouwmachines (OJ No. L 200 of 23.7.1983, p. 44); Samenwerkende Prijsregulerende Organisaties in de Bouwnijverheid (OJ No. L 92 of 07.4.1992, p. 1); FENEX (OJ No. L 181 of 20.07.1996, p. 28).
4. OECD (1997), *Competition Policy in OECD Countries 1994-1995*, p. 259.
5. See W. Sauter (1997), *Competition Law and Industrial Policy in the EU*, p. 117.
6. Note accompanying Bill for the Competition Act, 18 July 1995.
7. See OECD (1997), *The OECD Report on Regulatory Reform*, Paris.
8. *Annual Report on Competition Law and Policy in the Netherlands (July 1996-June 1997)*, (1997).
9. Here "dispensation" translates "ontheffing", which conveys the sense of case-by-case decision. In EU competition law, the same term, "exemption", is used both for general, "block" exemptions and for exemptions granted in case-by-case decisions.
10. Competition Act, Articles 12-14.
11. Competition Act, Article 12.
12. Competition Act, Articles 15, 17.
13. See *Financial Times*, 2 April 1998.
14. Competition Act, Article 100(1).
15. Royal Decree, 4 Feb. 1993; effective date, 1 July 1993.
16. OECD (1997), *Competition Policy in OECD Countries 1993-1994*, Paris.
17. These decisions are described in the government's *Annual Report on Competition Law and Policy in the Netherlands (July 1996-June 1997)*, (1997) and in the annual reports to the OECD, *Competition Policy in OECD Countries 1993-1994* (1997).
18. These decisions are described in the government's *Annual Report on Competition Law and Policy in the Netherlands (July 1996-June 1997)*, (1997) and in the annual reports to the OECD, *Competition Policy in OECD Countries 1993-1994* (1997).
19. See OECD (1994), *Competition Policy and Vertical Franchising Agreements*.
20. See European Commission, Green Paper on Vertical Restraints (31 January 1997).
21. Competition Act, Article 24.
22. *Annual Report on Competition Law and Policy in the Netherlands (July 1996-June 1997)*, (1997).
23. *Id.*
24. OECD (1997), *Competition Policy in OECD Countries 1993-1994*.
25. Article 22, Clause 3 of Council Regulation No. 4064/89.
26. Article 9, Clause 1, of Council Regulation No. 4064/89.
27. Competition Act, Article 91.
28. Competition Act, Article 78(3).

29. Competition Act, Article 16.
30. Competition Act, Articles 11, 25.
31. *Annual Report on Competition Law and Policy in the Netherlands (July 1996-June 1997)*, (1997).
32. Competition Act, Article 7.
33. The trade's price agreements also extended to imported (foreign) books, through fixing exchange rates; this form of price fixing was ended under pressure from the European Commission.
34. OECD (1997), Competition Law & Policy Committee, Roundtable on Resale Price Maintenance.
35. See R.C.G. Haffner and P.A.G. van Bergeijk, eds. (1997), *Regulatory Reform in the Netherlands – Macroeconomic Consequences and Industry Effects*, directie Marktwerking, Ministerie van Economische Zaken (Ministry of Economic Affairs), October.
36. See generally OECD (1997), *The OECD Report on Regulatory Reform*, Vol. 2, *Thematic Studies*, pp. 251-73, Paris.

# BACKGROUND REPORT ON ENHANCING MARKET OPENNESS THROUGH REGULATORY REFORM*

* This report was principally prepared by **Evdokia Moïsé,** Administrator of the Trade Directorate. It has benefited from extensive comments provided by colleagues throughout the OECD Secretariat, by the Government of the Netherlands, and by Member countries as part of the peer review process. This report was peer reviewed in July 1998 in the Working Party of the OECD's Trade Committee.

# TABLE OF CONTENTS

## Executive Summary

## Background Report on Enhancing Market Openness through Regulatory Reform

Does the national regulatory system allow enterprises to take full advantage of competitive global markets? Reducing regulatory barriers to trade and investment enables countries in an expanding global economy to benefit more fully from comparative advantage and innovation. This means that more market openness increases the benefits which consumers can draw from regulatory reform. Maintaining an open world trading system requires regulatory styles and content that promote global competition and economic integration, avoid trade disputes and improve trust and mutual confidence across borders. This report will assess regulations and the regulatory process in the Netherlands in terms of their effect on international competition through trade and investment, as well as the extent to which trade perspectives are incorporated into the general policy framework for regulations. This report shows that there is broad consistency in the principles of good regulation from both domestic and international perspectives. The analysis is built on six "efficient regulation" principles that elaborate the core principles of good regulation set out in the background report on Government Capacity to Assure High Quality Regulation and the background report on The Role of Competition Policy in Regulatory Reform with respect to their impact on foreign parties.

The prosperity of the Netherlands has historically been largely dependent on foreign trade and investment, resting on a long tradition of market openness. Dutch domestic and international policies have been geared to enhancing both the attractiveness of the domestic market for foreign businesses and the international competitiveness of Dutch firms. In this context, the Netherlands has largely subscribed to the "efficient regulation" principles in establishing rules and procedures, even if in many cases the principles have not been translated into formal requirements in developing domestic regulation. Transparency and openness of decision making with respect to foreign parties, as well as a general tendency to espouse non-discriminatory practices, seem well anchored in the consensus tradition of the Dutch society. Furthermore, the regulatory process in the Netherlands appears to have generally operated in a manner which seeks to fulfil legitimate policy objectives while ensuring international market openness as far as possible, by avoiding unnecessary trade restrictiveness and encouraging the reduction of technical barriers to trade. For example, the Netherlands has a strong record of use of internationally harmonised measures and of the recognition of equivalence of conformity assessment performed abroad.

However, the benefits of policies geared towards market openness may have been mitigated in the past by the strong corporatist tradition which may disadvantage new entrants, especially SMEs. In the absence of formalised rules and procedures, the self-regulatory approach commonly used may comprise a risk of exclusion of non-represented interests. In this light, even if market openness has not been a key issue in the reform efforts undertaken in the recent years in the Netherlands, reforms undertaken in other areas, and in particular with respect to competition policy, with a view to suppressing private anti-competitive behaviour have indirectly had a positive effect on market openness. It is probably in ensuring the application of competition principles that there may remain the largest potential for further future improvement in market openness.

## 1. MARKET OPENNESS AND REGULATION: THE POLICY ENVIRONMENT IN THE NETHERLANDS

The Netherlands has long enjoyed a reputation as a trading nation with one of the most open economies in the world. Given the relatively small size of the country, the prosperity of the Netherlands has largely been dependent on foreign trade and investment. The exceptional international orientation of the Dutch is demonstrated by a combination of high ratios of imports, exports and foreign investment (see Figures 1 and 2). The share of exports and imports of goods in terms of GDP is close to 50 per cent, well above those of other OECD countries and matched or exceeded only by Belgium and Ireland. Foreign investment also plays a key role in the Dutch economy. The Netherlands is the OECD country which, in relation to its GDP, invests the most abroad and is among the largest recipients of foreign investment.

The Netherlands' strategic location, with a 160-million consumer pool within a 300-mile radius from Amsterdam, its strong sea and air transport infrastructure as well as stable and business-friendly environment have not only made it an attractive platform from which to serve the European market, but also positioned it as an important transit country for European and especially German goods shipped outside Europe. More than 6 700 foreign companies employing over 380 000 people have established operations in the Netherlands and many have set up their European headquarters there. The Netherlands is one of the most important destinations of US direct investment in Europe, with over 1 300 US companies established, totalling 170 000 people employed. Nearly half of all US companies and around 40 per cent of Japanese companies that established a European distribution centre have chosen the Netherlands.

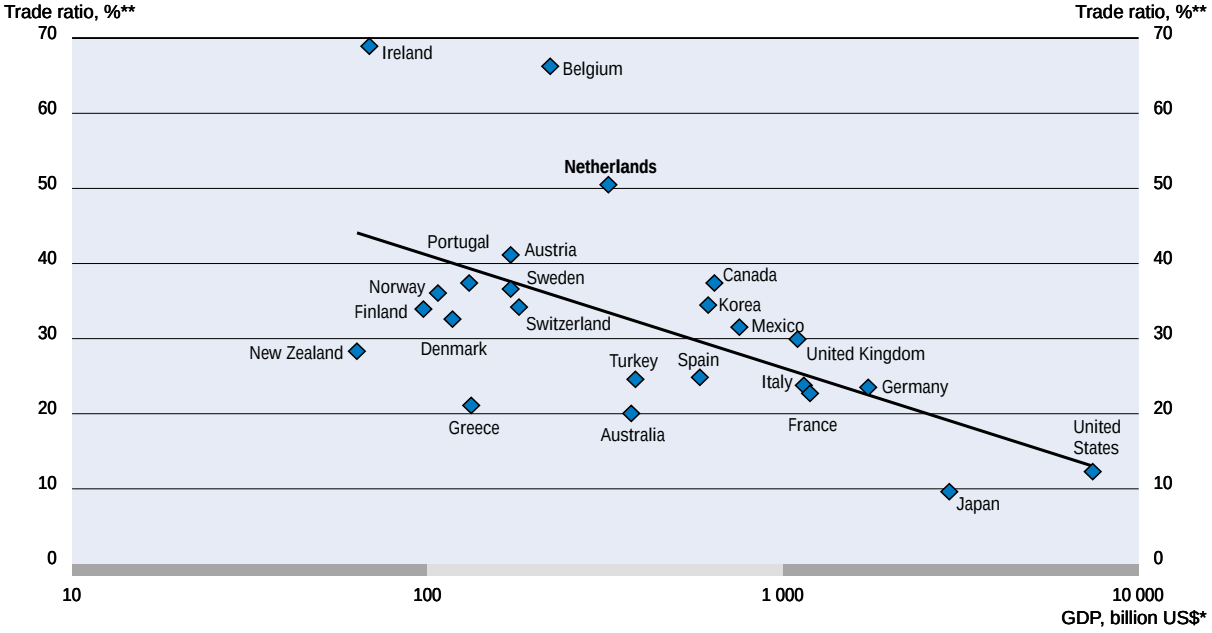
Awareness of the importance of foreign trade and investment for the prosperity of the country has induced a spirit of market openness at many levels of society and government, including among regulators and in the administration. This market openness orientation has been asserted through the participation of the Netherlands as a founding member of the GATT and ensuing commitment to WTO obligations, but also through its membership in the European Union. As the Netherlands has geared its domestic and international policies to enhancing both the attractiveness of the domestic market for foreign businesses and the international competitiveness of Dutch firms, it has been very active in trade liberalisation both in the European and international context. It has long maintained liberal policies towards foreign direct investment. As a matter of fact, it appears on certain occasions to have chosen to initiate domestically liberalisation in given sectors (*e.g.*, the steps taken to further liberalise the electricity sector ahead of the EU schedule, see background report on Regulatory Reform in the Electricity industry), *inter alia* so as to encourage trading partners to reciprocate with respect to Dutch products, services and capital. The Netherlands has rarely been at the centre of trade or investment disputes.[1] It has sought to provide a trade-friendly business environment and foreign trading partners surveys consistently express a high degree of satisfaction with the Dutch regulatory environment.[2]

Regulations and the regulatory process in the Netherlands of course have to be viewed also in the light of the Dutch membership in the European Union. In the Netherlands, as in all other European Union Members, a considerable amount of domestic regulation is shaped by the regulatory process at the European level and thus indirectly influenced also by the policies and regulatory culture of the other Members. The liberalisation of the Dutch market has certainly been enhanced by the ongoing process of European integration and the Single Market undertaking. It is considered that on balance the implementation of the internal market programme has improved the conditions under which third countries can access EU Member markets.[3] At the same time, the momentum of the European integration owes much to the Dutch tradition of market openness, which has consistently been one of the driving forces behind the liberalisation of European markets.

With a firmly entrenched trade- and investment-friendly regulatory environment, market openness for foreign suppliers has not been a key issue in the reform efforts undertaken in recent years in the Netherlands (see Chapter 1). However regulatory reform has indirectly affected market openness. This is particularly the case with respect to reforms in the field of competition policy (see the background report on The Role of Competition Policy in Regulatory Reform). In fields such as harmonisation of technical standards, European integration and in particular the completion of the Single Market has also given a welcome impetus to regulatory reform in the Netherlands. Other efforts, such as the deregulation of retail

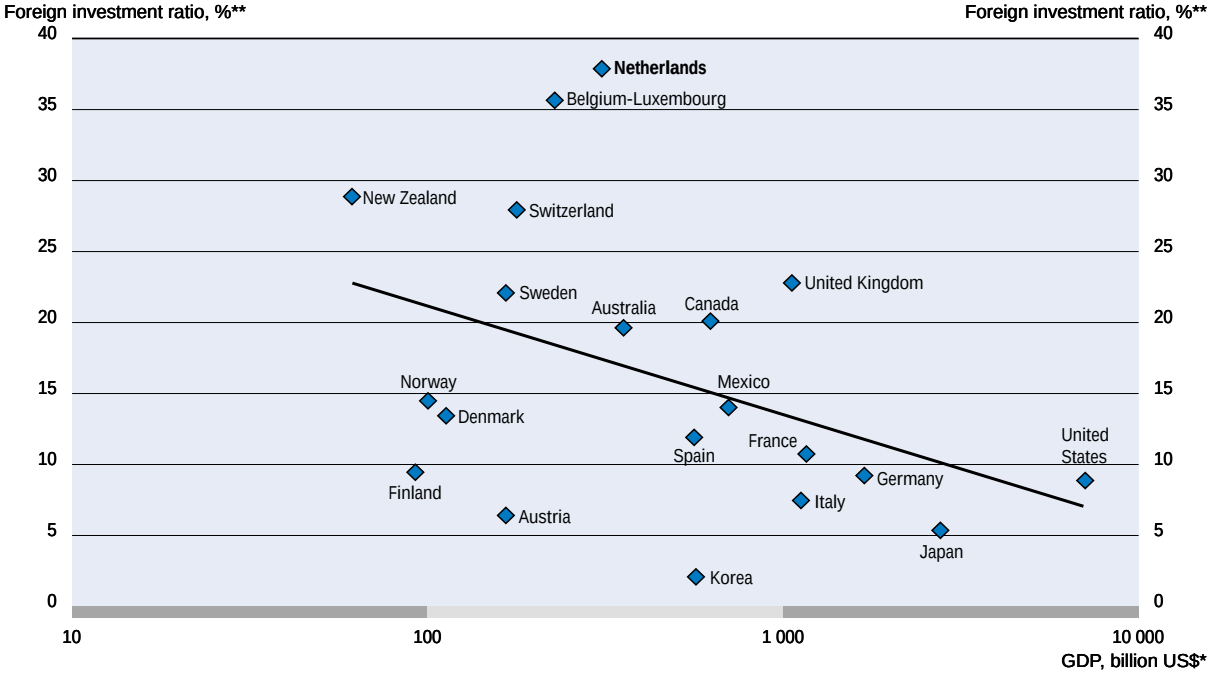
## Outward orientation of the Dutch economy

Figure 1. **Share of trade in selected OECD Member countries' economies, 1996**




* GDP measured at current prices and current PPPs in billion US dollars.
** Average of exports and imports of goods and services relative to GDP.
This ratio includes trade simply transiting through the Netherlands; however, this probably does not significantly distort the picture of market openness, since much of "transit" trade reflects the attractiveness of the Netherlands as a "gateway" to Europe.
*Source:* OECD.

Figure 2. **Share of stocks of inward and outward direct investment in GDP in 1995**




* GDP measured at current prices and current PPPs in billion US dollars.
** Average of inward investment and outward investment relative to GDP (except for Mexico, inward only).
*Source :* OECD, AFA databases (DSTI, EAS Division) and DAFFE's Foreign Investment Database.

opening hours, the accrued flexibility of fixed term contracts (legislation pending) and the creation of a central desk in the tax service for foreign investors and expatriates have reinforced the ability of foreign suppliers to compete in the Dutch market. However, it would be fair to say that there may be areas of the Dutch economy that have so far been untested in international competition. These are in particular service sectors concerned mainly or exclusively with domestic consumption, such as construction, utilities, certain financial transactions, or consumer services. In an increasingly globalised economic environment, these sectors will have to face international competition in the future and will have, as a consequence, to demonstrate that they live up to the market openness tradition characterising more generally the Dutch economy.

## 2. THE POLICY FRAMEWORK FOR MARKET OPENNESS: SIX "EFFICIENT REGULATION" PRINCIPLES

An important step in ensuring that regulations do not unnecessarily reduce market openness is to build the "efficient regulation" principles into the domestic regulatory process for social and economic regulations, as well as for administrative practices. "Market openness" here refers to the ability of foreign suppliers to compete in a national market without encountering discriminatory or excessively burdensome or restrictive conditions. These principles, which have been described in the 1997 *OECD Report on Regulatory Reform* and developed further in the Trade Committee,[4] are:

- *Transparency and openness of decision making.*
- *Non-discrimination.*
- *Avoidance of unnecessary trade restrictiveness.*
- *Use of internationally harmonised measures.*
- *Recognition of equivalence of other countries' regulatory measures.*
- *Application of competition principles.*

They have been identified by trade policy makers as key to market-oriented, trade-and-investment-friendly regulation. They reflect the basic principles underpinning the multilateral trading system, concerning which many countries have undertaken certain obligations in the WTO and other contexts. The intention in the OECD country reviews of regulatory reform is not to judge the extent to which any country may have undertaken and lived up to international commitments relating directly or indirectly to these principles; but rather to assess whether instruments, procedures and practices at the national level give effect to the principles and successfully contribute to market openness.

To a large extent the Netherlands has subscribed to the "efficient regulation" principles in designing domestic policies and establishing rules and procedures. Nevertheless in many cases the principles have not been translated into formal requirements in developing domestic regulation. In certain circumstances, described in the following sections, it thus appears that the regulatory processes in place may have the potential of allowing barriers to trade or investment to arise; however, the Secretariat is not aware of any actual problems or complaints to date.

### 2.1. Transparency and openness of decision making

In order to ensure international market openness, the process of creating, enforcing, reviewing or reforming regulations needs to be transparent and open to affected and interested parties, including foreign parties, both traders and investors. From an economic point of view, transparency is essential for market participants in several respects. Transparency in the sense of information availability offers market participants a clear picture of the rules on the basis of which the market operates, and enables them to accurately assess potential costs and market opportunities and to make informed production and investment choices. Such transparency is also a safeguard in favour of equality of competitive opportunities for market participants and thus enhances the security and predictability of the market. Transparency of decision-making also refers to a dialogue with affected parties, which opens the regulatory decision-making process to public comment, including at international levels, and gives consideration to

such comments prior to the adoption and implementation of decisions. Such dialogue allows to build market forces into the process and to avoid trade frictions.

As explained above, in the background report on the Government Capacity to Assure High Quality Regulation and the background report on The Role of Competition Policy in Regulatory Reform, the Netherlands is a consensus society, where socio-economic policy decision-making does not belong exclusively to the government, but where both co-operation between the government and social partners and self-regulation play a major role. Taking into account affected interests and seeking a smooth

### Box 1. Provision of information in the field of technical regulations: Notification obligations under Directive 83/189/EEC*

In order to avoid erecting new barriers to the free movement of goods which could arise from the adoption of technical regulations at the national level, European Union Member States are required by Directive 83/189 to notify all draft technical regulations on products, to the extent that these are not a transposition of European harmonised directives. This notification obligation covers all regulations at the national or regional level, which introduce technical specifications, the observance of which is compulsory in the case of marketing or use; but also fiscal and financial measures to encourage compliance with such specifications, and voluntary agreements to which a public authority is a party. Notified texts are further communicated by the Commission to the other Member States and are in principle not regarded as confidential, unless explicitly designated as such.

Following the notification, the concerned Member State must refrain from adopting the draft regulations for a period of three months during which the effects of these regulations on the Single Market are vetted by the Commission and the other Member States. If the Commission or a Member State emit a detailed opinion arguing that the proposed regulation constitutes a barrier to trade, the standstill period can be extended for another three months. Furthermore, if the preparation of new legislation in the same area is undertaken at the European Union level, the Commission can extend the standstill for another twelve months. An infringement procedure may be engaged in case of failure to notify or if the Member State concerned ignores a detailed opinion.

Although private parties are not the direct recipients of the notified draft regulations, they are the main beneficiaries. In order to bring draft national technical regulations to the notice of the European industry the Commission publishes regularly a list of notifications received in the Official Journal of the European Communities. Any firm interested in a notified draft and wishing to obtain further information may contact the relevant contact point in any Member state. In this way, a firm can obtain early information to enable it to adapt its production to future regulation in its export markets; it can also identify protectionist elements in the proposed regulation and take action through its government or the Commission to have such elements removed.

The position of private parties with respect to the Directive has been further enhanced by the recent *Securitel* decision of the European Court of Justice (Decision of 30 April 1996, CIA Security International SA versus Signalson SA and Securitel SPRL). The Court recognised a direct effect to the provisions of Directive 83/189 and confirmed that individuals may rely on them before the national courts which must decline to apply a national technical regulation which has not been notified in accordance with the Directive.

Similarly, as far as standards are concerned, Directive 83/189 provides for an exchange of information concerning the initiatives of the national standardisation organisations (NSOs) and, upon request, the working programmes, thus enhancing transparency and promoting co-operation among NSOs. The direct beneficiaries of the notification obligation of draft standards are the European Union Member States, their NSOs and the European Standardisation Bodies (CEN, CENELEC and ETSI). Private parties can indirectly become part of the standardisation procedures in countries other than their own, through their country's NSOs, which are ensured the possibility of taking an active or passive role in the standardisation work of other NSOs.

* See European Commission (1998), Directorate General for Industry, "Directive 83/189/EEC – A Commentary. Maintaining the Single Market. A Guide to the Procedure for the Provision of Information in the Field of Technical Standards and Regulations", Luxembourg.

implementation of policies through acceptance can be considered a typical feature of the Dutch socio-economic culture. Consultation with organised market interests, in particular capital and labour, has been long institutionalised, while the recent questioning of the representativeness of tripartite consultative structures has led, *inter alia*, to an increasing use of informal consultations. These consultations, which are conducted at the discretion of policy makers, have allowed a very flexible management of information seeking and consensus building, incorporating into the regulatory process all kinds of input deemed relevant within a given context. This consensus model has largely shaped the mechanisms for consultation and for ensuring transparency of the regulatory process, as described in detail in the background report on Government Capacity to Assure High Quality Regulation.

Information with respect to prospective and effective regulation is primarily provided by means of its publication in the *Staatsblad* (Official Gazette) prior to entry into force, as required by the Constitution. However, apart from this formal requirement, there is a limited, albeit increasing use of informal paths, including pre-publication "notice and comment" procedures and display of information on the Internet. Access of foreign parties to the information may be hindered in the Netherlands by the linguistic barrier. However, there is a constant effort to display abstracts of information of international interest in English, either through special publications, or on the Internet sites of administrations concerned. On the other hand, the access of third parties to regulation harmonised at the European level is facilitated by the availability of the information in all eleven official languages of the European Union.

In the particular field of technical standards and regulations, the Netherlands also provides information to its trading partners in the context of carrying out its notification obligations to the European Union and, through it, the WTO. Draft product regulations, elaborated by the central government or industry boards, are notified to the European Commission by virtue of Directive 83/189 when they are not pure transpositions of EU harmonising directives. Responsibility for prompt notification of draft regulations lies with the ministry concerned and is secured through the supervision of a notification co-ordinator appointed in every ministry. National standardisation organisations are required to notify new draft standards which are distinct from international or European standards.

In 1997 the Netherlands was the European Union Member which notified by far the largest number of prospective technical regulations (341 out of a total of 900 for all European Union Members).[5] However, this sizeable notification activity does not necessarily reflect a Dutch propensity to adopt national technical regulations. The number is inflated by the one-off notification of 230 regulations by the Dutch administration in the wake of the *1996 Securitel* ECJ ruling mentioned in Box 1. That case underlined the risk that unnotified domestic technical regulations might be declared subsequently unenforceable by the courts; in this light, the Dutch administration decided to notify all technical regulations adopted since 1984. The question arose of the necessity to further clarify the scope of notification obligations in Directive 83/189, which the Commission is pursuing, notably by codifying the directive and by the publication of an explanatory manual.

The 230 technical regulations which passed an intensive pre-notification scrutiny in co-operation with the Commission and were eventually notified by the Netherlands, were adapted where necessary to conform with Community law and so raised relatively few concerns with respect to their trade restrictiveness. Member States issued detailed opinions (arguing that the proposed regulation constitutes a barrier to trade) on only 10 notifications. On the remaining "regular" 111 notifications by the Netherlands in 1997, Member States issued 27 detailed opinions (24% of the 111 notifications) and the Commission on 12 (11%). During the same period Member States issued detailed opinions on 116 of the total 670 notifications for the European Union (17%) and the Commission on 115 (17%). Due to the post-Securitel operation all outstanding 8 infringement procedures initiated by the Commission[6] against technical regulations adopted by the Netherlands in violation of Directive 83/189 provisions, are in the process of being resolved.

To the extent that notified prospective regulations are not based on relevant international standards, the European Commission transmits[7] the information to the WTO Secretariat and other WTO Members in accordance with the obligation laid down by Article 2.9 of the WTO Agreement on Technical

Barriers to Trade. Similarly, notification required under other WTO provisions (such as Article 7 of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures, or regular notifications in the framework of WTO Agreements on agriculture, rules of origin, import licensing, etc.) is made to the WTO by the European Commission on behalf of Member States.

Foreign investors who seek access to the Dutch market can obtain information on business possibilities and regulatory conditions from the Netherlands Foreign Investment Agency (NFIA), which is part of the Ministry of Economic Affairs. The task of the NFIA is to facilitate direct investment of foreign companies in the Netherlands by providing information, strategic perspectives and practical assistance, including advice on available incentives, permit procedures or tax structures. Moreover, the NFIA presents itself as a gateway to the business network in the Netherlands, by organising contacts with government authorities or other organisations that may assist foreign parties in accessing the Dutch market. Furthermore, traders from developing countries can address the Centre for the Promotion of Imports from developing countries (CBI), operating within the policy framework set up by the Ministry of Foreign Affairs and the Minister for Development Co-operation. CBI supports SMEs and trade promotion organisations in developing countries in their promotion of exports to the Dutch and other European Union markets. For this reason it offers information and advice on how to meet regulatory requirements for products not only in the Netherlands, but also in the other EU countries. On the other hand, the Central Service for Import and Export (CDIU), which is part of the Ministry of Finance, has been designated in the framework of Directive 83/189 procedures to provide additional information on technical regulations notified by virtue of the Directive. Apart from the NFIA, the CBI and the CDIU in their respective fields of competence, there are no other centralised inquiry points where foreign parties can get information on the operation and enforcement of regulations. However, information about applicable legislation and regulations in the Netherlands can be obtained from Dutch embassies or directly from the respective Departments.

Foreign parties will in principle have the same opportunities for comments and consultation before the adoption of a new or modified regulation as domestic interest groups. However, when it comes to official consultation procedures arranged through semi-public bodies such as the Social Economic Council, access is not possible for parties that do not belong formally to those bodies, which can result in a *de facto* exclusion of foreign interests. As for other types of interests that lie outside the traditional social partners organisations, this exclusion is in practice counterbalanced by the use of informal consultations, which are open to affected and interested parties, be they domestic or foreign. This informal path is further used to lodge non-judicial complaints directly with the concerned administrations. So, the opportunities for foreign parties to bring comments and eventual grievances finally lie with the discretion of concerned authorities. Although such informal procedures have in general the drawback of lacking institutional safeguards, they appear in practice to be administered quite satisfactorily in the Netherlands thanks to the Dutch consensus tradition, the prevailing market openness orientation and the awareness of the increasing competition between EU Member states to attract investment.

The same problem of a *de facto* exclusion of foreign interests can be raised in the context of self-regulatory activities undertaken by the "statutory industrial organisation bodies" (PBOs)[8] and organisations such as the *Consumentenbond* (the Netherlands consumers association). Self-regulatory activities naturally give expression to the interests of the industries represented in the PBOs. For a long time this was not really an issue in the Netherlands as the PBOs were supposed to adequately express also the wider interests of the Dutch society. However, as increasingly diversified social concerns have emerged and as economies have globalised, the structure of these bodies may no longer provide sufficient room for taking into account third party concerns and this may in some cases undermine the general market openness orientation of the regulatory environment in the Netherlands. PBOs are not allowed to impede fair competition, but this provision goes only so far as to deter anti-competitive behaviour. It does not necessarily prevent PBOs from producing regulations which do not take adequate account of foreign parties concerns or which unnecessarily restrict trade. Current government controls over self-regulatory activities do not seem sufficient to ensure that PBOs subscribe to market openness principles the way the Dutch administration does. In this respect it would be useful for the government regularly to perform an assessment of the effects of self-regulatory activities on competitiveness and market openness.

However satisfactory transparency provisions may be in the Netherlands, they are not aimed at covering policies and regulations elaborated at the European level, even if there is a growing effort by the Dutch administration to expand transparency and consultation procedures, especially informal ones, to cover European regulation. In this respect a number of instruments are available at the European level in order to allow the views of non-European foreign partners to be taken into account, including the organisation of hearings and informal seminars and the use of informal consultations with foreign interests associations established in Brussels specifically for lobbying purposes. Foreign firms can and do make active use of these procedures. The effectiveness of information provision and the openness of decision making procedures in the European Union have been prominent subjects in the European political agenda since the ratification of the Maastricht Treaty in 1992 and considerable efforts have been undertaken to improve what was perceived as an unsatisfactory situation.[9] Increasingly information on proposed regulation is provided at an early stage of elaboration, including in the Official Journal and on the respective Internet sites of concerned Directorate Generals. These efforts were initially undertaken for the benefit of European citizens. Nevertheless, the improvements that have been achieved in recent years, as well as the shortfalls still needing to be addressed, affect both those citizens and foreign parties.

### 2.2. Measures to ensure non-discrimination

Application of non-discrimination aims at providing effective equality of competitive opportunities between like goods and services irrespective of origin. It calls for avoidance of making distinctions on the one hand between foreign partners from different countries, and on the other hand between domestic versus foreign products. Most-favoured nation (MFN) and national treatment principles are among the central principles and objectives of the multilateral trading system, even if their application in particular circumstances may be open to interpretation.

The Netherlands has subscribed to the MFN and national treatment principles *inter alia* in the context of its membership to the WTO. There is no overarching requirement in the Dutch law to incorporate non-discrimination principles into the regulatory decision-making process, other than the general prohibition of discrimination contained in the first article of the Dutch Constitution. Nevertheless, the Netherlands seems in general highly committed to these principles in the overall operation of its national administration and specific legal provisions ensuring the incorporation of non-discrimination principles into the national legal order have not been considered necessary. However, when explicit non-discrimination provisions are contained in a European directive, they have to be transposed in the national legal order through specific non-discrimination provisions. This for instance has been the case for articles 7 and 11 of Directive 96/92/EC on the internal market in electricity, which have been transposed in Articles 23 and 24 of the 1998 Dutch Electricity Act.

Exceptions to non-discrimination principles arise of course in relation to preferential agreements that apply to the Netherlands, or in the context of certain EU commitments undertaken in the framework of the GATS Agreement. The most important preferential agreement in which the Netherlands participates is the European Communities, while all other preferential agreements form an integral part of the common European Union trade policy (namely the agreements with EFTA countries, the association agreements with Central and Eastern European countries and Mediterranean countries, the Lomé Agreement with ACP countries and the General System of Preferences for developing countries). The implications of these agreements reach into many areas of the economy. For example, the preferential treatment in favour of EU Members and their nationals may have induced a wider tendency for the Netherlands to "buy European" instead of "national" in the context of government procurement.[10]

In considering proposals for new preferential agreements, the European Council addresses a number of strategic questions, including compatibility with all relevant WTO rules, the impact on the Community's other external commitments and the likelihood that the agreement would support the development of the multilateral trading system. Information on preferential agreements is made available to third parties in particular through notifications to the WTO. The WTO Committee on Regional Trading Agreements reviews all preferential agreements, in a process which consists amongst others of

written questions and answers. Within this context recourse is available for third countries which consider they are prejudiced by these agreements.

In the context of the GATS Agreement, the list of exemptions to MFN treatment as well as the schedule of commitments to national treatment have been decided at an EU-wide level and have been submitted to the WTO by the European Commission. These are composed of EU-wide exemptions and commitments as qualified by the additional restrictions attached by individual Member States (often replacing full commitments by partial commitments or unbound limitations). EU-wide commitments are generally considered to be among the least restrictive of any WTO member.[11] In addition, the Netherlands stands among the European Union Members which have introduced the least amount of additional restrictions to non-discrimination principles (mainly a limitation to cross-border supply of the services of office support personnel and limitations to the presence of natural persons in certain services sectors).

There is not a government body responsible for controlling the implementation of non-discrimination principles in the Netherlands. However, to the extent that those principles represent an international commitment of the country under the WTO, any violations will in principle be identified by the Legislative Department of the Ministry of Justice, which checks the quality of legislation, including the compliance with European Union and WTO rules. With respect to draft legislation proposed by regional or local authorities, concerned central authorities will try to avoid potential infringements by means of informal consultations, or by means of judicial action in case of failure. However, there is no record of problems of this type to date.

### 2.3. Measures to avoid unnecessary trade restrictiveness

When regulations have trade-restrictive effects, it is desirable for these not to go beyond what is needed to ensure achievement of the desired regulatory objective, taking into account technical and economic feasibility. The need to fulfil legitimate policy objectives while avoiding unnecessary trade restrictiveness both in the regulatory decision making process and in administrative procedures is acknowledged in the Netherlands as essential for achieving a cost-effective regulatory environment. In the past, although there was no formal requirement for assessing trade restrictiveness of proposed regulations, they were often tested against considerations of market openness and compatibility with international trade commitments of the Netherlands, for instance in the case of legislation on mandatory labelling of tropical timber, proposed in 1994 but withdrawn on these grounds.

In 1994-95 a new formal system of regulatory impact assessment (RIA) was adopted (see the background report on Government Capacity to Assure High Quality Regulation). The *Aanwijzingen voor de regelgeving* (Directives for Legislation) specified in this system specifically encourage regulatory and administrative procedures to avoid unnecessary trade restrictiveness. Among the fifteen questions which can be used for assessing the quality of draft regulations, seven deal with consequences of draft regulations for trade and industry, the functioning of the market and socio-economic developments. In September 1997, instructions for using these questions in an efficient way were published in the form of a "Business Effects Test (BET) checklist" and widely distributed in the Dutch administration.[12]

The BET checklist suggests assessing *inter alia*:

– The costs and benefits of draft regulations for the companies affected, including the assessment of financial and compliance costs and how these are spread among different business categories concerned.

– The relative effect of draft regulations with respect to the capacity of concerned companies and whether these regulations will restrict the companies' possibilities to develop new products and services, taking into account the intensity of competition in the affected market segment.

– The relative burden imposed on trade and industry by the draft regulation as compared to the burden of comparable regulations among the Netherlands' main competitors.

– The consequences of draft regulations for the operation of the market and in particular the conditions that such regulations may impose with respect to market entry or market behaviour and the effects that they may have on market structure.

This Business Effects Test is performed by the regulating ministry in co-operation with the Ministries of Economic Affairs and Justice. As a first step, the Interdepartmental Proposed Legislation Working Group (IPLWG) determines in consultation with the concerned department whether the type of the proposed regulation warrants the performance of a business effect test, and, in that case, which of the questions included in the checklist should be answered. Subsequently the assessment of the effects on trade and investment is based *inter alia* on trade policy expertise provided by the Helpdesk operated by the Ministry of Economic Affairs. Trade policy makers may suggest, but do not have the prerogative to request, the modification or withdrawal of domestic regulations of other departments on the grounds of unnecessary trade restrictiveness. However, co-ordination among the various departments appears satisfactory on this account, so that the institution of such a formal prerogative does not seem necessary.

This system does not include any complaint procedures for market participants. Any grievances can only be taken into account in the context of informal consultation procedures, as described in Section 2.1. Furthermore, the scope of the business effects test is limited to legislation and regulation produced under ministerial responsibility and does not cover parliamentary initiatives. In the latter case, such as the new proposal for mandatory labelling of timber and timber products which has been introduced in February 1998 on parliamentary initiative, the only path for assessing effects on trade and investment will be to test against considerations of compatibility with international trade commitments, as in 1994 (see first paragraph in Section 2.3). Experience with the operation of the business effect test is still fairly limited and has not to date led to the modification or withdrawal of proposed regulation on the grounds of unnecessary trade restrictiveness. There are no provisions requiring assessment of the effects on trade and investment of self-regulatory activities (see Section 2.1 above).

The effects of proposed regulation on trade and investment are also assessed from a more procedural point of view by the Legislative Department of the Ministry of Justice, which checks the quality of legislation, including the compliance with WTO and EU rules. As a matter of fact, the participation of the Netherlands in the Single Market entails a clear commitment *vis-à-vis* other EU Member States towards avoiding unnecessary trade restrictiveness of domestic regulations with respect to the areas covered by the Single Market. A typical example is offered by Directive 83/189/EEC (see Section 2.1), where technical regulations drafted at the domestic level are subject to the scrutiny of the Commission and other Member States with a view to preventing the creation of new technical barriers to intra-Community trade. The directive provides that the notifying Member State can proceed with the enactment of the regulation without waiting for the expiration of the standstill for urgent reasons relating to the protection of public health and safety; however, it cannot use this provision as an excuse for introducing a disguised restriction on trade between Member States.

As far as the effects of European regulations are concerned, while there are no specific provisions requiring an assessment of the impact of new regulations on international trade and investment, the general framework in which Community regulations are developed (through inter-Service co-ordination) and enacted (involving discussions with Member States and decisions, where appropriate, by other European institutions such as the Council of Ministers and the Parliament) is aimed at ensuring that draft regulations are also considered in this light. However, tangible policy results relating to trade restrictiveness will inevitably be affected by the highly complex institutional structure of the European Union. EU policies are shaped to a considerable extent by the need to make room for diverging political considerations among Member countries or among policy communities. This process potentially allows the expression of third party concerns; but it may also sometimes lead to side-stepping those concerns when consensus among intra-EU concerns seems too difficult to reach.

### 2.4. Measures to encourage use of internationally harmonised measures.

Disparities of technical standards and regulations between countries, often explained by natural and historical reasons, relating to climate, geography, natural resources or production traditions, can

### Box 2. Harmonisation in the European Union[1]: The New Approach and the Global Approach

The need to harmonise technical regulations when diverging rules from Member States impair the operation of the common market was recognised by the Treaty of Rome in Articles 100 to 102 on the approximation of laws. By 1985 it had become clear that relying only on the traditional harmonisation approach would not allow the achievement of the Single Market. As a matter of fact, this approach was encumbered by very detailed specifications which were difficult and time consuming to adopt at the political level, burdensome to control at the implementation level and requiring frequent updates to adapt to technical progress. The adoption of a new policy towards technical harmonisation and standardisation was thus necessary to actually ensure the free movement of goods instituted by the Single Market. The way to achieve this was opened by the European Court of Justice, which in its celebrated ruling on *Cassis de Dijon*[2] interpreted Article 30 of the EC Treaty as requiring that goods lawfully marketed in one Member State be accepted in other Member States, unless their national rules required a higher level of protection on one or more of a short list of overriding objectives. This opened the door to a policy based on mutual recognition of required levels of protection and to harmonisation focusing only on those levels, not the technical solution for meeting the level of protection.

In 1985 the Council adopted the **"New Approach",** according to which harmonisation would no longer result in detailed technical rules, but would be limited to defining the essential health, safety and other[3] requirements which industrial products must meet before they can be marketed. This "New Approach" to harmonisation was supplemented in 1989 by the **"Global Approach"** which established conformity assessment procedures, criteria relating to the independence and quality of certification bodies, mutual recognition and accreditation. Since the New Approach calls for essential requirements to be harmonised and made mandatory by directives, this approach is appropriate only where it is genuinely possible to distinguish between essential requirements and technical specifications; where a wide range of products is sufficiently homogenous or a horizontal risk identifiable to allow common essential requirements; and where the product area or risk concerned is suitable for standardisation. Furthermore, the New Approach has not been applied to sectors where Community legislation was well advanced prior to 1985.

On the basis of the New Approach manufacturers are only bound by essential requirements, which are written with a view to being generic, not requiring updating and not implying a unique technical solution. They are free to use any technical specification they deem appropriate to meet these requirements. Products which conform are allowed free circulation in the European market.

For the New Approach, detailed harmonised standards are not indispensable. However, they do offer a privileged route for demonstrating compliance with the essential requirements. The elaboration at European level of technical specifications which meet those requirements is no longer the responsibility of the EU government bodies but has been entrusted to three European standardisation bodies mandated by the Commission on the basis of General Orientations agreed between them and the Commission. The CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standards) and ETSI (European Telecommunications Standards Institute) are all signatories to the WTO TBT Code of Good Practice. When harmonised standards produced by the CEN, CENELEC or ETSI are identified by the Commission as corresponding to a specific set of essential requirements, the references are published in the Official Journal and they become effective as soon as one Member State has transposed them at the national level and retracted any conflicting national standards. These standards are not mandatory. However conformity with them confers a presumption of conformity with the essential requirements set by the New Approach Directives in all Member States.

The manufacturer can always choose to demonstrate conformity with the essential requirements by other means. This is clearly necessary where harmonised European standards are not (or not yet) available. Each New Approach directive specifies the conformity assessment procedures to be used. These are chosen among the list of equivalent procedures established by the Global Approach (the so-called "modules"), and respond to different needs in specific situations. They range from the supplier's declaration of conformity, through third party type examination, to full product quality assurance. National public authorities are responsible for identifying and notifying competent bodies, entitled to perform the conformity assessment, but do not themselves intervene in the conformity assessment. When third party intervention is required, suppliers may address any of the notified bodies within the European Union. Products which have successfully undergone the appropriate assessment procedures are then affixed the CE marking, which grants free circulation in all Member States, but also implies that the producer accepts full liability for the product.[4]

Box 2. **Harmonisation in the European Union: The New Approach and the Global Approach** *(cont.)*

The strength of the New Approach and the Global Approach lies in limiting legal requirements to what is essential and leaving to the producer the choice of the technical solution to meet this requirement. At the same time, by introduction EU-wide competition between notified bodies and by building confidence in their competence through accreditation, conformity assessment is distanced from national control. The standards system, rather than being a means of imposing government-decided requirements, is put at the service of industry to offer viable solutions to the need to meet essential requirements, which however are not in principle binding. The success of the New and Global Approaches in creating a more flexible and efficient harmonised standardisation process in the European Union heavily depends on the reliability of the European standardisation and certification bodies and on the actual efficiency of control by Member States. First European standardisation and certification bodies need to have a high degree of technical competence, impartiality and independence from vested interests, as well as to be able to elaborate the standards necessary for giving concrete expression to the essential requirements in an expeditious manner. Second each Member State has the responsibility to ensure that the CE marking is respected and that only products conforming with the essential requirements are sold on its market. If tests carried out by a notified body are cast in doubt, this should be followed up by the supervisory authorities of the Member State concerned.

1. See Dennis Swann (1995), *The Economics of the Common Market*, Penguin Books; European Commission (1996), "Documents on the New Approach and the Global Approach", III/2113/96 – EN; European Commission, DGIII Industry, "Regulating Products. Practical Experience with Measures to Eliminate Barriers in the Single Market"; ETSI "European Standards, a Win-win Situation"; European Commission (1994), "Guide to the Implementation of Community Harmonisation Directives Based on the New Approach and the Global Approach (first version)", Luxembourg.
2. Decision of 20 February 1979, Cassis de Dijon, Case 120/78, ECR, p. 649.
3. Energy-efficiency, labelling, environment, noise.
4. Council Directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning the liability for defective products.

frequently create trade distortions by introducing non-tariff barriers for products and services. The reduction of such barriers through the international harmonisation of standards and regulations is one of the main objectives of the WTO Agreement on Technical Barriers to Trade (TBT) and can be considered as the essential pillar of the construction of the European Single Market. The achievement of the Single Market has further reinforced the Netherlands' avowed policy of encouraging the adoption of regulations based on internationally harmonised measures.

The Dutch policy with respect to technical regulations aims at limiting, wherever possible, government intervention to the setting of essential requirements and leaving technical details to be worked out by means of standardisation, testing and certification by and for industry. In the context of the MDW project, the Dutch government actively seeks to promote standardisation, testing and certification by market players as an alternative to government regulation.[13] As noted by the Ministry of Economic Affairs,[14] "*effective interaction between the government, industry and institutes in the field of standardisation, testing and certification will help the Netherlands to achieve a decisive economic position, thereby boosting the competitiveness of companies which must be afforded maximum scope to sell their goods and services on the international market*".

The prerogatives of the Netherlands administration with respect to standardisation have thus been transferred to the Netherlands Standardisation Institute (NNI), which is the national central standardisation body. The NNI is a private institution with multiple standardisation activities, whose relationship with the Netherlands government is ruled by an agreement under Dutch civil law. This agreement provides that the Netherlands' international obligations under Directive 83/189/EEC (see above, Section 2.1) and under the WTO TBT Agreement will be fulfilled by the NNI on behalf of the Netherlands government. The NNI thus assumes the public function of implementing European and international standards and withdrawing any national standards which are not a simple transposition of existing European and international standards applicable for the same subject. However, the activities

## NNI standardisation activities
## Standards published by the NNI by 1 July 1996

Figure 3. **Finalised technical standards**

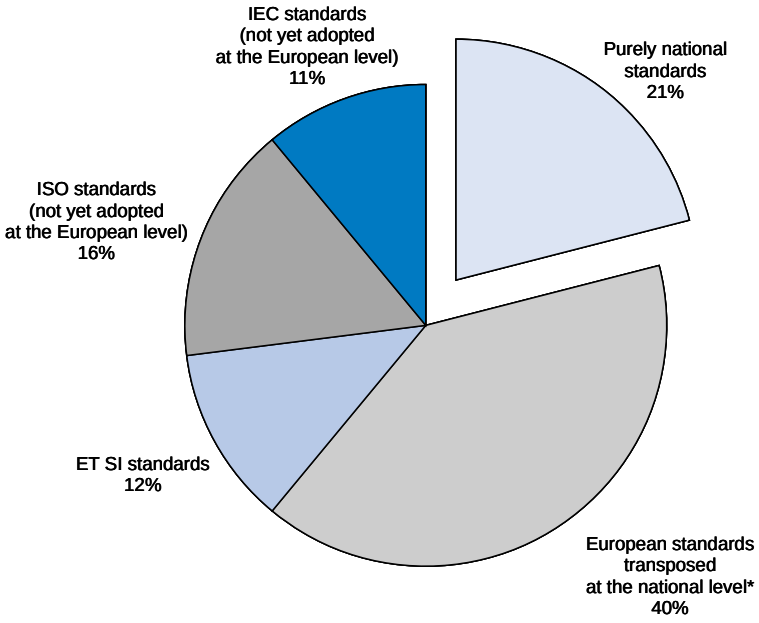
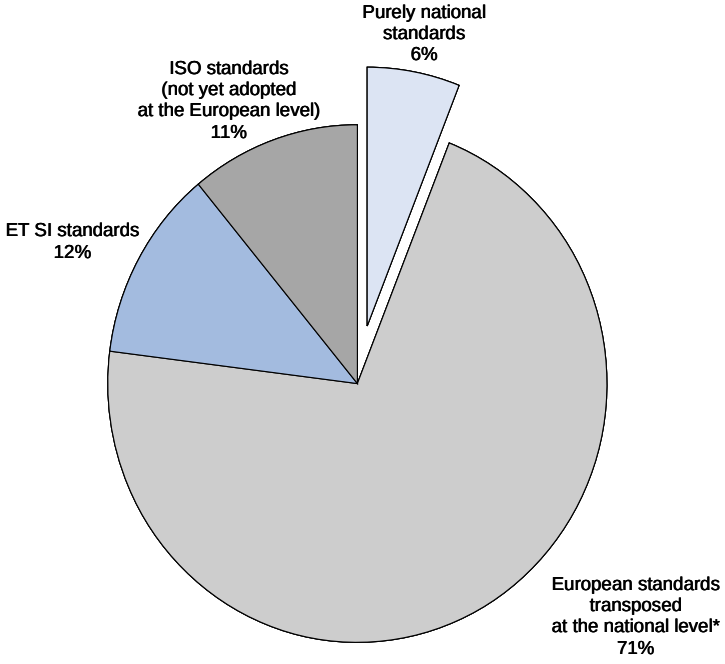



Figure 4. **Draft technical standards**




* CEN-CENELEC, including standards originally produced by ISO and IEC.
*Source:* OECD on the basis of figures published by the NNI on http:/www.nni.nl

of the NNI, including those with a public relevance, are not considered administrative acts and cannot be contested before administrative tribunals. The regulatory activities of the NNI are financed by the Dutch government, which preserves ultimate control and responsibility over them.

NNI's standardisation activities are clearly geared towards the adoption of international standards, resulting in an easier access of foreign products to the domestic market as well as an additional competitive edge in the global market for Dutch producers. The NNI has accepted the WTO TBT Code of Good Practice for the preparation, adoption and application of standards and is thus committed to operate according to the principles set therein. The breakdown of NNI standardisation activities demonstrates its international orientation. By July 1996 the NNI had published over 9 000 finalised technical standards, only a fifth of which were purely national standards. The rest of them had been transpositions either from European standards (CEN, CENELEC and ETSI) or international standards (IEC and ISO) not yet adopted at the European level. Furthermore, the NNI shows considerable transparency with respect to its standardisation activities and in making relevant information publicly available, including on the Internet. It thus appears that the Netherlands is not only mindful of existing international standards, but goes beyond the level of harmonisation required by its European obligations.

In July 1996 over 3 500 draft standards were under preparation. A large majority of them were transpositions of European standards (over 80%) and ISO standards. Only 6% of these draft standards were purely national. This evolution translates mainly the increasing effort of harmonisation within the European Union. The number of purely Dutch draft standards is on the wane as the scope for European harmonisation has increased and limited the need for national standards. Similarly the NNI is less busy with harmonising against existing international standards as this work is increasingly done by European standardisation bodies. The adoption of harmonised standards is thus increasingly related to the European Single Market.

The Netherlands, as dictated by New Approach directives, has enacted legislation on the operation of certification procedures under the responsibility of the concerned ministries, implementing the "modules" laid down by the Global Approach with respect to the affixing of CE-marking. In that manner, the administration can evaluate more easily whether the applicable product requirements are met, while at the same time it avoids unnecessary burden on economic operators by allowing them to choose the modules that seem most appropriate for a particular sector or product.

The basic principle which underlies European standardisation is subsidiarity with respect to global standards, based on the assumption that conformity of European standards to global standards is likely to facilitate access of European products to world markets. Apart from the standardisation work mandated by the Commission (see the Box 2), most standards are prepared at the request of industry. Since a growing number of European and national standards are in fact transpositions of international standards produced by ISO, IEC and ITU, various initiatives have been developed at the European level to promote transparency and co-operation at the international level:

- The standardisation process is undertaken in close co-operation with all parties involved, such as the Member States (through the membership of all European Union national standardisation bodies), industry and consumers (through the representation of industry, consumers, and trade unions associations on the technical committees and working parties responsible for the preparation of the standards) and trading partners (through the association with EFTA and other countries and the co-operation agreements described below); the standards produced are publicly available by means of paper and electronic publications of the standardisation bodies, as well as of official publications of the European Commission.
- The numbering of European standards clearly indicates the relationship with international standards, for instance, whenever a CEN standard is a transposition of an ISO standard it will be referenced by the same number by simply adding the EN prefix in front of the ISO prefix (f.i. EN-ISO 5079 on textile fibres); the same applies for national references (f.i. NEN-EN-ISO 5079).
- Co-operation agreements have been signed between ISO and CEN (Vienna Agreement) and between IEC and CENELEC (Dresden Agreement) to secure the highest possible degree of approximation

between European and international standards and avoid duplication of work. A similar agreement is being prepared by ETSI and ITU to take into account the specificities of telecommunications.

– Furthermore, the European Union is a party to the UN-ECE 1958 Agreement on Automotive Standards. This agreement provides a basis for the technical approval of motor vehicle equipment and parts. It has been supplemented by additional regulations developed by the UN-ECE Working Party on the Construction of Vehicles. UN-ECE regulations have played a major role in the harmonization process of regulations within the European Union. Thirty-five of them have been recognized equivalent to EU directives which specify technical requirements for the type approval of motor vehicles.

### 2.5. Recognition of equivalence of other countries' regulatory measures

In cases where the harmonisation of regulatory measures is not considered feasible or necessary, the recognition of equivalence of other countries' regulatory measures in attaining the same regulatory objective may be the most appropriate avenue for reducing technical barriers related to regulatory divergence. Within the European Union the principle of mutual recognition applies among Member States, in the sense that all products lawfully manufactured in one Member State must be accepted by the others even when they have been manufactured in accordance with technical regulations which differ from those laid down by existing national legislation, provided they meet the marketing conditions in the originating Member State.[15] Thus, for the Netherlands, as for all other European Union Members, the extent to which the equivalence of other countries' regulatory measures is recognised has to be assessed with respect to regulatory measures introduced by third (non-EU Member) countries.

In the Netherlands, such recognition of equivalence is largely based on testing and certification conducted by private bodies. Indeed, as explained above in Section 2.4, in the framework of the MDW project the Dutch government actively seeks to promote private testing and certification instead of government involvement. Further considering that the position of the Netherlands as an important import and transit point for the European market makes it an attractive location for testing and certification bodies and laboratories, it has been promoting the creation of an open market for certification and testing at the European and international level. Dutch, as well as foreign certification bodies can be accredited by the Netherlands Council for Accreditation (RvA), although such accreditation is not mandatory. The RvA is a private institution under Netherlands civil law, but, similarly to the NNI, it carries out a number of public functions with respect to conformity assessment on behalf of the Dutch government. In this context it assumes *inter alia* the international obligations of the Netherlands under the WTO Agreement on Technical Barriers to Trade, namely with respect to non-discrimination and avoidance of unnecessary trade restrictiveness (TBT Art. 5 and seq. on *Conformity with Technical Regulations and Standards*). The RvA can also provide information and advice to foreign parties as far as conformity assessment in the Netherlands is concerned.

Foreign certification bodies also have the possibility, instead of being accredited by the RvA, to be recognised on the basis of their accreditation by a foreign accreditation body with which the RvA has a mutual recognition agreement. These agreements, which are of a private nature, can be either bilateral or concluded in the framework of international fora such as the European Co-operation for Accreditation (EA)[16] the International Accreditation Forum (IAF),[17] or the International Laboratory Accreditation Co-operation (ILAC).[18] They have to be approved by the Dutch government, which preserves ultimate control and responsibility over them. In the framework of the public functions assumed by the RvA, the accreditation of the results of certification and testing performed abroad, as well as the recognition of equivalence of foreign accreditation, is subsequently accepted by the Dutch authorities as concerns the marketing of certified products in the Dutch market. In other words, a foreign manufacturer can enter the Dutch market on the basis of a certificate or test report issued by a foreign certification body accredited by a foreign accreditation body if the latter is recognised as equivalent by the RvA.

Policies aimed at recognising the equivalence of regulatory measures and results of conformity assessment performed in third countries are also elaborated at the European Union level, although their implementation is partly incumbent on national authorities or institutions. Recognition by the European Union of the equivalence of third countries' regulatory measures, including the results of conformity

Table 1. **Mutual Recognition Agreements concluded or under negotiation by the European Union**

| | Australia | Canada | Japan | New Zealand | Switzerland | United States | Czech Rep. |
|---|---|---|---|---|---|---|---|
| Agrofood biotechnology | | | | | | N | |
| Construction equipment | | | | | N | | |
| Electrical safety | N | N | N | N | N | N | |
| Electromagnetic compatibility | × | × | N | × | N | × | |
| Fasteners | | | | | | N | |
| Gas appliances | | | | | N | | |
| Lawn movers | | | | | N | | |
| Machinery | × | | N | × | N | | |
| Measuring instruments | | | | | N | | |
| Medical devices | × | × | N | × | N | ×N* | |
| Motor vehicles | × | | | | N | | |
| Pharmaceutical GMP | × | × | N | × | N | × | |
| Phytopharmaceuticals | | | | | N | | |
| Pressure equipment | × | | N | × | N | | |
| Recreational craft | | × | | | N | × | |
| Telecommunications equipment | × | × | N | × | N | × | |
| Toys | | | | | N | | |
| Tractors | | | | | N | | |
| Veterinary equivalence | | N | | × | N | × | × |

×: Sectors for which agreement has been reached.
N: Sectors under negotiation.
*: Agreement has been reached only for part of medical devices.

assessment performed in those countries, is based on the negotiation and adoption of Mutual Recognition Agreements (MRAs). On the basis of negotiating directives issued by the Council in 1992 the European Commission has negotiated agreements on the mutual recognition of conformity assessment with the United States, Canada, New Zealand and Australia. The signature of the MRAs between the European Union and the above mentioned countries is expected to take place during the months of May and June 1998, and the agreements will be effective from early autumn 1998. The European Commission has completed negotiations with Switzerland and is currently also negotiating a similar agreement with Japan.

Each MRA consists of a framework agreement and a series of sectoral annexes. The coverage of sectoral annexes concluded or under negotiation is presented in Table 1. The framework agreements specify the conditions by which each party will accept or recognise the results of conformity assessment procedures produced by the other party's conformity assessment bodies or authorities, on the basis of the requirements set by the importing party. These requirements are specified on a sector-specific basis in the sectoral annexes. In other words, there is no recognition between the parties of the equivalence of their respective regulatory requirements; however, if a conformity assessment body in the exporting party certifies that a product covered by the MRA is in conformity to the requirements set by the importing party, this certification will have to be accepted as equivalent by the importing party. The negotiation and conclusion by the European Commission of MRAs on conformity assessment is subject to certain conditions, the most important of which is the assurance that the competence of conformity assessment bodies in the third country is and remains on a par with that required of their European Union counterparts. It will be interesting to see how successful these agreements will be in reducing technical barriers related to regulatory divergence between their participants and whether their benefits will be sufficient to justify the difficulty of their negotiation, taking into account that additional sectors might be negotiated at a later date.

### 2.6. Application of competition principles

The application of competition principles in the context of regulatory reform is addressed in detail in Section 3.3 of the background report on The Role of Competition Policy in Regulatory Reform from

the perspective of competition policy. The focus in the current report is the extent to which reform policies have been able to deal effectively with private anti-competitive behaviour affecting foreign entry to the Dutch market. As a matter of fact, the strong corporatist tradition and the lack of enforcement of competition principles which earned the Netherlands its "cartel paradise" reputation, appear to have complicated access to the Dutch market for foreign new entrants, especially SMEs.[19] The introduction of a new competition law on 1st January 1998 has the potential of remedying this situation in the future (for a detailed analysis, see background report on The role of competition policy in regulatory reform). Ensuring that the new law and supporting policies are effective in suppressing private anti-competitive behaviour affecting foreign entry to markets will probably be the main challenge with respect to market openness in the Netherlands in the near future.

Under the Dutch competition law, foreign firms receive national treatment. Therefore, foreign firms have the same rights as domestic ones to apply for exemptions or licenses, to submit views or objections concerning applications by others, to bring complaints to NMa, to take action if dissatisfied with how those complaints are resolved, or to bring private actions. Accordingly, to the extent that market access problems can be remedied by recourse to the competition law, foreign firms may have an effective means of seeking relief.

With respect to regulatory action taken by agencies other than the NMa, no explicit procedures are available by which foreign firms can influence the regulatory process. It is not clear to what extent Dutch law permits foreign or domestic firms to intervene as a matter of right in regulatory proceedings if they believe that regulatory action or private conduct is impairing their access to the Dutch market. However, foreign firms can present their views during the legislative process in parliament in various ways, such as sending in their written comments, lobbying and meeting with members of parliament.

With respect to regulatory action, no explicit procedures are available for foreign or domestic firms to seek relief when firms subject to regulation which creates or strengthens their market power in one market exert or extend that power in another market. However, to the extent that an incumbent firm engages in a practice prohibited by the competition legislation, there may be some scope for a foreign firm to use the private right of action to have the practice prohibited or declared "null".

## 3. ASSESSING RESULTS IN SELECTED SECTORS

**Electricity:** There is a significant reliance on imported electricity (about 13%) in the Netherlands and several long-term contracts between the generators co-operative and utilities in neighbouring countries will ensure continued imports over the next decade. Consistent with the EC electricity directive, the new Dutch electricity law permits customers with the ability to choose suppliers (and by 2007, all customers) to import electricity from other countries. However, in accordance with reciprocity provisions in this directive, imports are not permitted without Ministerial dispensation from countries where customers of same type are not permitted to choose suppliers. The background report on Regulatory Reform in the Electricity Industry discusses further the likely effectiveness and implications of these provisions on competition in the Dutch electricity market and, in particular, their potential to reduce the openness which currently characterises this market.

**Telecommunications services:** The Netherlands committed to open its domestic telecommunications market in the context of the WTO Agreement on basic telecommunications services. It has introduced no exceptions or conditions to the EU-wide commitment offering complete liberalisation of basic telecommunications services (facilities-based and resale) across the EU for all market segments (local, long distance and international), including satellite networks and services and all mobile and personal communications services and systems. As a result, access to the Dutch market is totally open to foreign service providers, including call-back service providers. Service providers do not need to have a legally registered representative in the Netherlands to provide a service in the country. There are no restrictions regarding to foreign ownership size of share holding or other ownership restrictions on individuals and corporations investing in telecommunications services. The only issue of discriminatory treatment may possibly be raised with respect to an exemption from special access obligations that can be

Figure 5. **Draft regulations notified by the Netherlands to the European Commission**

Draft regulations notified by sector, 1997*

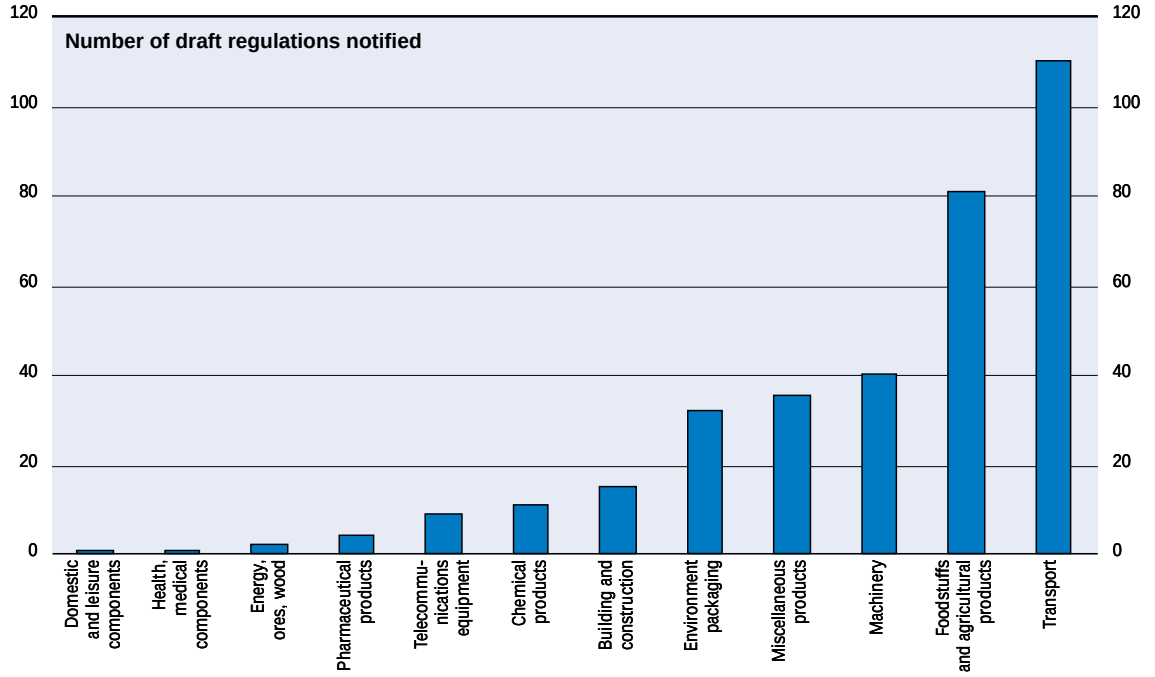
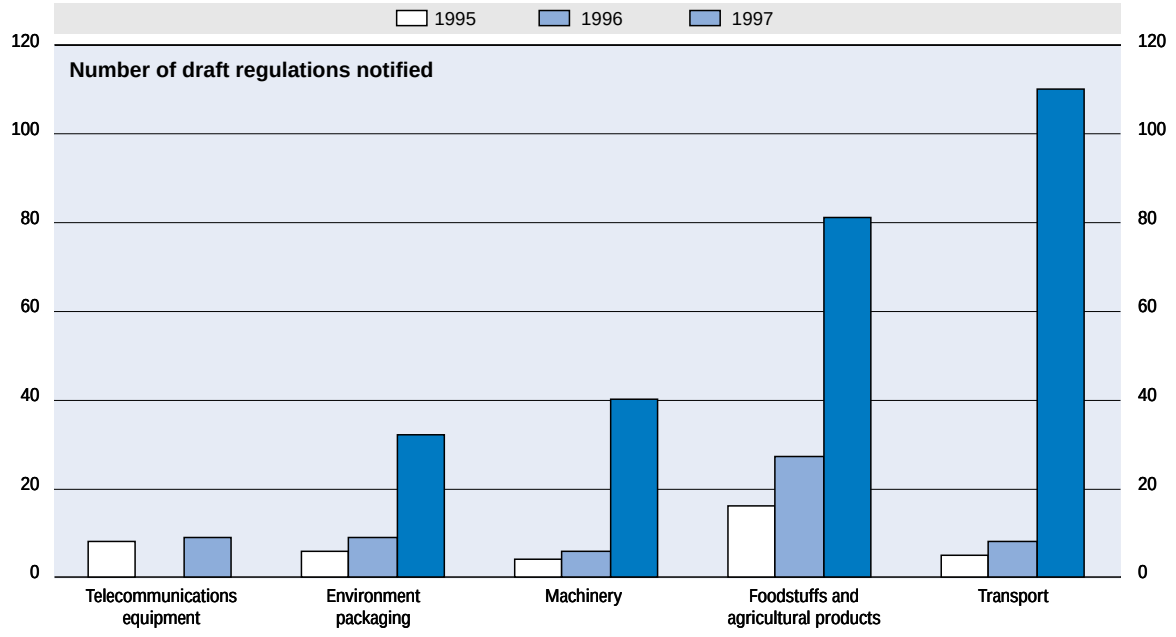



Figure 6. **Draft regulations notified between 1995 and 1997* in selected sectors**




* 1997 figures are provisional.

*Source:* *Official Journal of the European Communities,* Statistics relating to technical regulations notified within the framework of Directive 83/189 EEC.

granted to companies by the Minister of Transport and Public Works when the special access concerns the provision of public telecommunications services to and from another country.[20] The background report on Regulatory Reform in the Telecommunications Industry discusses further market openness and application of competition principles in the sector of telecommunications services in the Netherlands.

**Automobiles and components:** The Netherlands' automotive parts and components sector is dominated by imports, accounting for 70% of the total market. Technical requirements for motor vehicles are applicable throughout the European Union, including the Netherlands. They are elaborated by the European Commission in consultation with Member States and promulgated by the EU Council as EU Directives. There are in total 54 "Old Approach" directives dealing with active and passive safety measures, lighting measures and environmental protection, focusing mainly on vehicle emissions. The European Union operates a regime of "type approval" for vehicles which meet the technical requirements of applicable directives. The certification of type approval for specific components or whole vehicles may be granted in any EU Member State and recognised as valid in all Members.

**Transport:** With respect to foreign investment some limitations to the application of non-discrimination principles based on nationality or residence can be found in the transport sector. The Dutch Aviation Law along with EC Regulation and Bilateral Aviation Treaties limit licenses to operate an airline on the basis of nationality and ownership requirements, and reserve cabotage to national airlines unless the provisions of international agreements to which the Netherlands is a partly imply otherwise. Given the size of the country, the limitation on cabotage does not actually imply major restrictions in market access for foreign airlines companies. In the case of rail transport, access of foreign railways to the Dutch network is granted on a reciprocal basis. Some nationality requirements can also be found in the maritime transport sector. The right to fly the Netherlands flag is reserved for ships on the basis of their owners' EU or EEA (European Economic Area) nationality. As signatory of the Revised Convention for Navigation on the Rhine, the Netherlands restricts the right to carry out transport of goods and persons on the Rhine in order to preserve the use of the inland waterways to Parties to the Convention.

**Audio-visual:** In the broadcasting field Dutch legislation provides for some restrictions to foreign investment based on cultural reasons. Participation in the public broadcasting service is limited to associations or groups which are socially or culturally embedded in the Netherlands society. Commercial broadcasters have a limited access to frequencies, some of which can be reserved to broadcasting in Dutch language or to other specific categories. This limitation restricts the participation of foreign broadcasting organisations, as well as the access of non-Dutch broadcasters to radio frequencies.

**Agriculture and food products:** Technical regulations with respect to agriculture and food products year after year account for the largest share of Directive 83/189/EEC notifications provided by the Dutch administration. A sizeable part of the Dutch notifications in these sectors is linked to the modification of the national framework law on the control of the quality of products, an area which is not covered by European Union regulation. The elaboration of a series of quality specifications for agriculture and food products produced in the Netherlands is aimed at ensuring a high quality competitive edge for products exported to demanding foreign markets, such as Japan. As a matter of fact, the Netherlands is the third largest exporter of agricultural products in the world. The proliferation of country specific technical regulations in these sectors also reflect the importance of health and safety concerns for the Dutch society.

## 4. CONCLUSIONS AND POLICY OPTIONS FOR REFORM

### 4.1. General assessment of current strengths and weaknesses

A review of the national regulatory system in the Netherlands shows that domestic policies, just like trade policies, have been effectively geared to enabling international competition in the Dutch market while enhancing the international competitiveness of Dutch firms. Although in many cases the "efficient regulation" principles have not been translated into formal requirements when developing domestic regulations, the principles seem to be well observed in practice within the domestic regulatory process. It

can be convincingly argued that the trading tradition and the awareness of the importance of foreign trade and investment for the prosperity of the country are so well anchored in the mentalities of public and private sector alike that institutional safeguards may be superfluous.

However, the issue can be raised whether, in the absence of a more global view of potentially affected interests, including foreign ones, self-regulatory activities undertaken by private bodies can adequately observe principles like transparency, non-discrimination or least trade restrictiveness. Given the importance of self-regulatory activities in the Netherlands, if delegated regulation did not respect the "efficient regulation" principles, this would undermine the objective of the open market sought by government regulation. The potential threat that may represent the strong corporatist tradition of the Netherlands may be counterbalanced by the newly introduced reforms in the field of competition policy. How these reforms will perform in further enhancing market openness in the Netherlands still remains to be seen, although the significant movement away from the corporatist tradition that takes shape in the Dutch society (see the background report on Government Capacity to Assure High Quality Regulation) seems promising in this respect.

### 4.2. The dynamic view: the pace and direction of change

In the context of an economy that performs already well with respect to market openness the country's traditions should provide a strong orientation. The contribution of a trade- and investment-friendly regulatory environment to the attractiveness of the Dutch market can only be an asset in increasingly globalised European and world economies. As border barriers lose their relative significance, the observance of the "efficient regulation" principles will become even more prominent in ensuring the competitiveness of the national economy in global markets. The development of a consistent practice for the assessment of trade and investment effects of proposed regulations will further enhance the role of these principles in providing additional impetus to market opening policies in the Netherlands.

Furthermore, in the Netherlands as in other countries, sectors that were hardly exposed to international competition up to now will have to undergo the test of efficient operation too. It is hard to say for the Netherlands whether sectors such as construction, utilities or consumer services, are potentially as open as sectors which have long been exposed to international competition, because the domestic consumer market has been relatively small compared to market segments exposed to international competition to really matter for international economic operators. In the future, demonstrating that these sectors can live up to the national traditions of market openness, so as to be able to reap the benefits of reform, will be a major challenge for the Netherlands.

### 4.3. Potential benefits and costs of further regulatory reform

The Netherlands has steadfastly reaped the benefits of its market openness tradition and reputation by attracting investment and trade flows that boost the Dutch economy, as well as by conferring to the national industry an appreciable advance experience of operation in global markets. Reforms aimed at further enhancing the market orientation of the national regulatory system will allow it to maintain its head start in the framework of the progressing liberalisation of global markets. The fine-tuning of market opening policies will thus need to pay credit, preserve and build upon past and current accomplishments. For instance, the increased reliance on market initiatives with respect to standardisation, testing and certification, as recommended in the 1997 OECD report on Regulatory Reform, has helped minimise any negative economic effects from the use of technical requirements for regulatory purposes and stimulated technological development. Thus, any wider action to improve the accountability of self-regulated private bodies and to ensure the regular assessment of trade and investment effects of their activities, should not overburden these activities in a way that would run counter to the objective of promoting market forces as an alternative to government intervention.

### 4.4. Policy options for consideration

Policy options for reform with respect to market openness in the Netherlands are mainly a question of further strengthening the market orientation of the national regulatory system. This would in essence include:

– *Strengthen competition policy to effectively deal with private anti-competitive behaviour affecting foreign entry to the Dutch market.* The vigorous application of the new Competition Law, as recommended in the background report on The Role of Competition Policy in Regulatory Reform, would considerably reduce the potential for private behaviour to mitigate the benefits of market opening public policies.

– *Improve the transparency of regulatory activities by private bodies, in particular as concerns the possibility of taking account of foreign interests.* A more explicit definition of the regulatory responsibilities, as well as an increased accountability of these bodies, as recommended in Chapter 2, could enhance the overall transparency of the Dutch regulatory process and facilitate the expression of foreign interests.

– *Develop a consistent practice for the assessment of trade and investment effects of proposed regulations on the basis of the BET procedures.* The BET checklist seems to offer a good basis for carrying out such assessment, although implementation of the improvements to RIA processes recommended in Chapter 2 is needed to ensure that it is able to fulfil this function effectively in practice. The efficiency of BET procedures could also be enhanced by further promoting the incorporation of foreign concerns in the regulatory process, namely by means of informal consultations.

– *Regularly assess the effects of self-regulatory activities on competitiveness and market openness.* Given the importance of self-regulatory activities in the Netherlands the assessment of trade and investment effects of proposed regulations is equally, if not more, justified at the self-regulatory level than at the governmental level. The development of government surveillance over PBO regulation with respect to trade and investment effects will have to achieve the delicate balance of enhancing market openness while preserving the legitimate goal of promoting market forces as an alternative to government intervention.

– *Continue to encourage the use of international standards as a basis for national standardisation activities and to promote international harmonisation in the European and international fora.* A strong commitment to an efficient and reliable standardisation system not only enhances market opportunities for Dutch firms but also greatly contributes to the consolidation worldwide of efficient and transparent markets for industry and consumers alike.

– *Further promote private standardisation, testing and certification as an alternative to government intervention.* Taking into account the complexity of intergovernmental MRA negotiations, an increased reliance on market initiatives towards recognition of equivalence may often be a response better adapted to the increasing speed of technological development.

# NOTES

1. A recent exception being the complaint by the United States to the WTO on "Certain Income Tax Measures (Constituting Subsidies", dated 5 May 1998 (WT/DS128/1). Similar complaints were also formulated against France, Ireland, Greece and Belgium.
2. See, for example, the US Department of State, 1997 Country Reports on Economic Policy and Trade Practices at *http://www.state.gov*, the US Department of Commerce, "Netherlands Trade Regulations and Standards" and "Netherlands Investment Climate", 21.08.1996, STAT-USA on the Internet (202) 482-1986, the Canadian Ministry of Industry site at *http://strategis.ic.gc.ca*, the New Zealand Trade Country Profiles at *http://www.tradenz.govt.nz*, or the American Chamber of Commerce in the Netherlands "*Investors' Agenda of Priority Points*", The Hague, 1998.
3. OECD (1997), "The European Union's Trade Policies and their Economic Effects", Paris.
4. OECD (1997), "Assessing the effectiveness of the efficient regulation principles", Paris.
5. These are provisional figures.
6. This figure does not relate to national technical regulations adopted in 1997, but to procedures undertaken that year by the Commission on the basis of Article 169 of the EC Treaty, as well as procedures undertaken in previous years and still outstanding. The total EC figure for that year is 94 (21 initiated that year, plus 73 outstanding).
7. This notification procedure is separate from that of Directive 83/189/EEC.
8. The PBOs are industry and trade organisations with substantial powers of self-regulation. They are composed of representatives of business organisations and unions and are most significant in sectors dominated by small businesses. For a more detailed description of the self-regulatory activities of the PBOs, see background report on The Role of Competition Policy in Regulatory Reform.
9. See European Institute of Public Administration (1998), "Openness and Transparency in the European Union", edited by Veerle Deckmyn and Ian Thomson, Maastricht.
10. See, for instance, US Department of Commerce (1996), "Netherlands Trade Regulations and Standards", 21 August, STAT-USA on the Internet (202) 482-1986.
11. See, for instance, USITC (1995), "General Agreement on Trade in Services: Examination of Major Trading Partners' Schedules of Commitments", Publication 2940, December, which notes that the additional restrictions attached by EU Member States increase significantly the restrictiveness of the European Union market for services.
12. Ministry for Economic Affairs (1997), "BET-Checklist. Questions for the Testing of Draft Regulations on Business Effects", September.
13. A.B. Ringeling *et al.* (1996), "Normalisatie en certificatie, Achtergrondstudies Algemeen Wetgevingsbeleid", Ministry of Economic Affairs and Ministry of Justice, February and Ministry of Economic Affairs (1997), "Follow up van het MDW-rapport Normalisatie en Certificatie", 30 May. See also Ministry of Economic Affairs (1995), Directorate General for Industry, "Standards, Certificates and Open Frontiers", May.
14. Ministry of Economic Affairs (1995), Directorate General for Industry, "Standards, Certificates and Open Frontiers", May.
15. The limits of this principle, such as the exception in Article 36 of the EEC Treaty, led to the efforts for harmonisation of technical specifications for products and subsequently to the adoption of the "New Approach".
16. The European Co-operation for Accreditation regroups the nationally recognised accreditation bodies of the Member countries of the EU and EFTA. It aims at promoting the conclusion of mutual recognition agreements among its members, so as to maintain the equivalence of competence of such bodies and ensure that products "*tested or certified once are accepted everywhere*".

17. The International Accreditation Forum is a group of accreditation bodies from various countries, including Australia, Canada, Japan, Mexico, the Netherlands, New Zealand and the United States.

18. The International Laboratory Accreditation Co-operation is an international co-operation between the various laboratory accreditation schemes operated throughout the world and aims, *inter alia*, at the conclusion of mutual recognition agreements between members on the basis of the ISO/IEC Guide 25 on laboratory accreditation.

19. See, for instance, US Department of Commerce (1996), "Netherlands Trade Regulations and Standards", 21 August, STAT-USA on the Internet, (202) 482-1986.

20. Based on the original draft of the new Telecommunications Act.

# BACKGROUND REPORT ON REGULATORY REFORM IN THE ELECTRICITY INDUSTRY*

* This report was principally prepared by **Peter Fraser** of the International Energy Agency with the participation of **Sally Van Siclen**, Principal Administrator, of the OECD's Division for Competition Law and Policy, **Bernard J. Phillips,** Head of Division for the OECD's Division for Competition Law and Policy, and **Caroline Varley,** Head of Division, Office of Long Term Co-operation and Policy Analysis of the IEA. It has benefited from extensive comments provided by colleagues throughout the IEA and OECD Secretariats, by the Government of the Netherlands, and by Member countries as part of the peer review process. This report was peer reviewed in October 1998 by the Standing Group on Long Term Co-operation of the IEA and the Competition Law and Policy Committee of the OECD.

# TABLE OF CONTENTS



*Tables*



*Figures*

## Executive Summary

## Background Report on Regulatory Reform in the Electricity Industry

Although the electricity sector accounts for less than one per cent of employment and two per cent of Dutch GDP, the sector is strategically important as a key input to other sectors of the Dutch economy. Liberalising the electricity market could improve capital and labour productivity, reducing electricity prices and boosting output.

The current market liberalisation of the Dutch electricity sector is the result of three drivers: broader government efforts at regulatory reform, a desire to address problems with the current electricity regulatory framework, and a need to comply with the EU directive on electricity market liberalisation. The Dutch government has passed a new electricity law that will liberalise the Dutch electricity market in stages between 1999 and 2007. A new network regulator is to be created that will work in close co-ordination with the new competition authority. New independent entities, the transmission and distribution network managers, are to be created to ensure non-discriminatory access to the networks.

Are the proposed reforms adequate to create effective markets for electricity in the Netherlands? The reforms offer good prospects for generation competition, effective regulatory co-ordination between sector and competition regulation, a sound stranded cost recovery plan, the development of a power exchange, and competitive neutrality. But in other areas the reforms need to be improved. Specifically:

- Delays in enacting the new law, and the details of the regulatory framework are worrying. The Dutch government must ensure the new law and regulations are put in place as soon as possible.
- Continued common municipal/provincial ownership of competitive (generation/supply) and network (transmission/distribution) businesses provides scope for discrimination against new entrants. Greater efficiency and more competition could be achieved if generation and supply were separately owned and managed from transmission and distribution. The network regulator should apply the requirements for vertical separation stringently so that owners of network assets are encouraged to divest their other assets.
- Customer choice, which is fundamental to an effective market, is being introduced too slowly. The timetable should be advanced, and small customers should be able to take advantage of competition earlier through aggregation.
- The role of the Minister as a regulator in this new market is potentially too extensive and consideration should be given to delegating more duties to the new regulator and competition authority.
- The convergence between the gas and electricity sectors means that the role of Gasunie (a pipeline and supply monopoly which is 50% state-owned) as a potential competitor in the electricity sector could have a distorting effect on electricity competition. The natural gas sector should be restructured to the same extent and regulated in the same manner and by the same regulators as electricity.

## 1. CURRENT FEATURES OF THE ELECTRICITY SECTOR

### 1.1. Key features

The current Dutch electricity sector is distinguished by the influence of environmental and energy security policies on the type and composition of generating capacity, by its publicly owned monopolies, and by the previous efforts of the national government to increase economic efficiency by partially restructuring the industry and introducing limited competition in generation. More specifically, the sector is characterised by:

- **A strong environmental policy influence:** The Dutch electricity sector is strongly influenced by the Dutch government's policies to reduce carbon dioxide emissions (to stabilise emissions at 1990 levels by the year 2000) and improve the energy sustainability of the economy. This policy context, which includes subsidies and favourable gas prices, has encouraged large industries and the distributors to construct combined heat and power generation (CHP) capacity to compete with existing utility generation, CHP now produces 26% of electricity supplied for the Dutch market. This is one of the largest shares in the OECD. Government policy has included significant subsidies and programs to boost energy efficiency and renewable energy by the utilities, the costs of which have been passed on to customers.
- **Energy security concerns and a high reliance on natural gas:** About 60 per cent of Dutch power generation uses natural gas (the highest in IEA countries) a domestic fuel. The Dutch Government remains concerned by this level of dependence on a single source and has established policies to favour fuel diversification (in practice to favour electricity generation from renewable sources).
- **Public ownership of electric utility monopolies through municipal/provincial governments:** The four "production"[1] companies responsible for central generation and high voltage transmission and the twenty three companies responsible for distribution and supply are monopolies ultimately owned by municipal and provincial governments. Continued public ownership of electricity supply has been supported by national policies such as the exemption of publicly-owned utilities from paying corporate taxes.
- **A partially restructured industry to encourage economic efficiency:** The 1989 Electricity Act made several changes to improve the efficiency of the sector. It split generation and transmission from the downstream activities of distribution and supply. Economic efficiency was to be encouraged by introducing competition in generation, and particularly by encouraging distribution companies to enter generation as separate businesses to compete with the production companies. Large users (above 20 GWh) were permitted (at least in principle) to choose suppliers.
- **A production cartel:** The 1989 Electricity Act also required the four production companies to work in co-ordination through SEP (the Dutch Electricity Generating Board) controlling all central generation, the high voltage network, system dispatch and imports and sales to the distributors at prices regulated by the Government. This was also intended to improve economic efficiency by allowing SEP to optimise use of central generating facilities.
- **Ownership links between production and distribution.** Two of the production companies are fully-owned by distributors (which are, in turn, owned by the municipal/provincial governments).

A more detailed description of the sector structure is dealt with in the next section, followed by a description of key policies affecting the sector, and the legal/regulatory framework.

### 1.2. Structural features (prior to 1998 Electricity Act)

#### *Generation*

The central generation sector consists of four regional generation and transmission public limited companies, generating 61 per cent of total electric power produced for the Dutch market. Each company is owned by a number of municipalities or provinces, either directly or through their distribution firms

(Table 1). The four co-ordinate their activities through SEP (N.V. Samenwerkende electriciteitsproductiebedrijven – Dutch Electricity Generating Board) a public limited company jointly owned by the four producers. SEP also acts as system operator, dispatching power and selling electricity to suppliers at an average cost price. SEP also owns the national grid and an integrated coal gasification combined cycle (IGCC) generating station – a relatively new "clean coal" technology – at Buggenum.

Table 1. **Shareholders of the production companies**

| Production company (and description of region) | Shareholders |
|---|---|
| EPON – Northeast Netherlands | NUON, EDON (distributors owned in turn by provincial and municipal governments) |
| EPZ – South Netherlands | DELTA, PNEM, MEGA (distributors owned in turn by provincial and municipal governments) |
| UNA – Amsterdam, Utrecht, and Northwest Netherlands | Province of North Holland, Amsterdam City Council, Pegus (holding company for Utrecht province and city) |
| EZH – includes Rotterdam, The Hague | Province South Holland, city councils of Rotterdam, Dordrecht, the Hague, Delft, Leiden, ENECO (distributor) |

Decentralised combined heat and power (CHP) generation accounted for about 26% of the power generated for Dutch consumption in 1997 – 20% produced by industry (oil refining, paper, chemicals, food and horticultural sectors are significant power producers) and the other 6% produced by the energy distribution companies.

Imports by SEP – mostly from France and Germany – account for the remaining 13% of power consumption. As SEP enjoys a statutory monopoly over imports, this means it controls 74 per cent of power supplied to the Dutch market. 1997 electricity production is summarised in Table 2 below.

Table 2. **1997 electricity production for Dutch market**

| Producer | Capacity (MW) | Generation TWh (%) |
|---|---|---|
| EPON | 4 978 | 19.3 (20%) |
| EPZ | 3 858 | 14.7 (15%) |
| UNA | 3 472 | 12.3 (13%) |
| EZH | 2 282 | 11.2 (12%) |
| SEP | 253 | 1.1 (1%) |
| Total central production | | 58.6 (61%) |
| Decentral/CHP | 5 280 | 24.6 (26%) |
| Imports | | 12.8 (13%) |
| Total | 19 870 | 96.1 (100%) |

*Source:* EiN, (1997).

Fuel mix for domestic electricity generation shows a significant dependence on natural gas (about 60 % – the highest among IEA countries) – not surprising considering the availability of low cost natural gas in the Netherlands. Coal, purchased on the world market, accounts for 25%. Oil-fired generation, mainly by refineries using CHP, accounts for another 4%. There is a small nuclear program (4% of supply in 1997). One small reactor, Dodewaard (55 MW), was closed in 1997. In 1994, the government decided that the remaining reactor, Borssele (450 MW), is to be closed in 2004.

### *Transmission*

SEP has a statutory monopoly over the operation of the high-voltage (380 kV/220 kV) system. SEP acts as system co-ordinator with a single control centre for the Netherlands, overseeing the economic dispatch of plant. There are currently no significant domestic transmission constraints.

There are good interconnections with neighbouring countries compared to OECD countries. Nameplate interconnection capability of the system is about 12 000 MW – equal to the peak demand of the system – but operational import limits are much lower than this – approximately 4 000 MW capacity or 40 per cent of consumption.

SEP also has statutory responsibility for transmission system expansion planning and managing expansion of the network.

***Distribution and supply***

Distribution and supply to 7 million electricity consumers occurs through 23 municipal or provincial authorities constituted as public limited companies operating under a monopoly concession. All distributors also distribute natural gas (although there are additional gas distributors that do not distribute electricity) and 11 have district heating systems as well.

Significant voluntary consolidation has been occurring, in order to improve efficiency of operations. Since 1985, the number of electricity distributors has dropped from 68 to 23.

Distribution (the low voltage physical transportation of electricity) and supply are currently bundled activities, *i.e.*, they are carried out by the same company, and suppliers independent of transportation did not exist. Recently very large users (greater than 20 GWh) have been able to take advantage of their liberalised situation and switch suppliers.

### 1.3. Policy drivers

A key policy driver is environmental policy. There is a commitment to control national emissions of carbon dioxide at 1990 levels by the year 2000. This commitment has resulted in a number of policies, programs, and economic instruments aimed at improving energy efficiency, of which promotion of Combined Heat and Power (CHP) electricity generation was the most significant.

As part of the Dutch strategy, industry sectors including electricity production and distribution were encouraged to enter into covenants (see the background report on Government Capacity to Assure High Quality Regulation) with the government on improving energy efficiency. In 1991, the distribution utilities adopted an Environmental Action Plan as part of the national Environmental Action Plan (MAP 2000) (EnergieNed, 1997). Plan measures are aimed at increasing energy efficiency through demand side programs, and through supply side measures (for which subsidies were available) in promoting CHP, landfill gas recovery, district heating and renewable energy. These measures are supposed to result in net savings of 17 million tonnes of $CO_2$ by the year 2000 (equivalent to about 10 per cent of Dutch national emissions). Direct costs of the environmental programs of the distribution utilities are estimated to raise the domestic electricity bill by 0.8% (PiE, 1998*d*).

In addition to subsidies and voluntary agreements, the government has introduced the Regulatory Energy Tax (REB) (MEZ, 1997), which has raised electricity prices to households and small consumers by 15%. Renewable energy is exempt from the tax. As the tax is applied only to a small amount of energy used, the impact of the tax on large users is small (0.8%).[2]

Renewable energy is another major component of energy policy in the Netherlands. The government has set a target of 10 per cent of primary energy supply from renewable resources by 2020 (*MEZ, 1997)*. Additional measures include a number of different subsidies:

– Exemption of renewable energy sales from the REB.

– Tax relief for renewable energy projects.

– Green investment funds that are tax exempt for investments in renewable energy.

– Direct funding by the government (totally approximately 110 million DFl in 1998).

As part of their environmental initiatives, utilities are also offering “green pricing” of renewable electricity to customers at a premium of 0.04 DFl/kWh, about 15% above the cost of regular supplies

(PiE, 1997*c*). These premiums do not, in general, recover the entire additional cost of renewables, and the remainder is recovered from all customers through rates.

A second key, and linked, policy driver affecting the electricity sector is the Dutch Government's concern over energy security and over-reliance on natural gas. Dutch Government energy policies have emphasised the importance of conserving domestic natural gas reserves (the only significant indigenous energy resource). They have also identified the risks to the Dutch economy of over-reliance on a single-fuel source and have used a variety of measures (*e.g.*, government ownership of production and transportation of gas, prices linked to oil product prices, and in the past, dedicated reserves for the Dutch market) to manage the use of this resource.

These energy security/fuel diversity concerns have had two practical impacts on the electricity sector:

– Policies to favour the efficient use of natural gas in power generation (particularly combined heat and power stations (CHP)) are a cornerstone of the 1989 Electricity Act.

– Policies to encourage fuel diversity in power generation particularly through increased use of renewable electricity generation have led to a number of subsidies and special programmes to develop renewable resources.

Last but certainly not least, a third policy driver which has been growing in importance is the objective of improving the sector's economic efficiency. As the section below explains, the 1989 Electricity Act was a first important attempt to rework the regulatory framework to encourage greater efficiency.

### 1.4. Regulatory framework

The 1989 Electricity Act is the cornerstone of the current framework and was implemented to promote a more efficient sector (as well as to promote CHP for environmental reasons). It requires the four regional production companies to work together through SEP in order to reduce costs through economies of scale. The Government (Ministry of Economic Affairs) regulates the prices the production companies are able to charge the distributors, as well as the retail tariffs charged to customers.

There is only limited freedom to contract in the Dutch electricity market. The 1989 Electricity Act allows an individual production company to sell directly to a distributor. In turn, a large user (> 20 GWh consumption) is able, in principle, to contract with different distribution companies other than its local company. In practice, however, very little energy is sold this way because of the very small price differences (the non-transparency of transmission rates (CPB, 1997) and a perception of high transaction costs are also factors). End user choice is, in practice, a limited feature of the current framework.

SEP has a statutory monopoly on imports and exports, although large users (but not distributors) could import electricity, with SEP acting as co-ordinator. In practice, little energy is imported this way, for similar reasons that large users have tended to stay with their local company (unknown transaction costs and a lack of transparency of transmission rates).

Entry since 1989 has been very different for central generation as opposed to decentralised generation. Entry to central power generation has been tightly controlled. Central power generation requires a license, which specifies a minimum size of 2 500 megawatts (MW). As this is larger than one of the four production companies, and far larger than the minimum efficient scale for power generation of a few hundred megawatts, this requirement has the effect of excluding new entrants. Individual central generation projects by the existing producers are subject to a planning process that requires parliamentary review. Ministerial approval is subject to further judicial reviews on such matters as environmental acceptability of the project (MEZ, 1996*a*). These regulations limit incentives to construct new central generation capacity.

By contrast, the 1989 Electricity Act strongly encourages market entry by decentralised combined heat and power (CHP) for environmental reasons. A variety of incentives – including investment subsidies until 1993 (up to 17.5% was provided by the government), an obligation to purchase the surplus

generated from these facilities at estimated full cost of new central generation facilities (up until 1995), favourable natural gas prices provided by the 50 per cent state-owned gas supplier Gasunie, and an exemption (up until 1997) from paying for ancillary services (such as reserve capacity) have resulted in a doubling of the CHP contribution over 1990 (CPB, 1997).

Total domestic capacity in 1997 was nearly 20 000 MW on actual peak demand of less than 15 000 MW (including load displacement) – leaving a reserve margin of approximately 33% – far greater than necessary.

Renewable energy has benefited from even more favourable conditions, as discussed elsewhere.

## 2. REFORM OF THE ELECTRICITY SECTOR

### 2.1. Policy context

The previous section set out the historical and current context of the Netherlands electricity sector. The 1989 Act implemented some changes aimed at increasing efficiency. However, the Netherlands is now poised for further reforms aimed at stimulating even greater efficiency. The latest efforts at market liberalisation of the Dutch electricity sector are the result of three drivers: broader government efforts at regulatory reform, a desire to address problems with the current electricity regulatory framework, which has fallen short of the expectations of greater efficiency, and a need to comply with the EU directive on electricity market liberalisation.

The first driver is the broad national government program for regulatory reform to improve the competitiveness of the Netherlands relatively small, open economy. Market liberalisation in the network industries such as electricity and telecommunications (background report on Regulatory Reform in the Telecommunications Industry) have been accompanied by an effort to reduce regulation by government (background report on Government Capacity to Assure High Quality Regulation) and introduce a stricter competition regime (background report on The Role of Competition Policy in Regulatory Reform).

Second, it was clear that the electricity sector needed further reform. The 1989 Electricity Act had taken a step towards creating competition by partly restructuring the sector (into generation and transmission on the one hand, and distribution and supply on the other) and establishing favourable rules for combined heat and power (CHP) production. However, it had failed to create effective competition because the functions of generation and supply (both potentially competitive) were still tied in with transportation (a natural monopoly). It had also created further over-capacity problems by the way in which the CHP policies were implemented. Particular problems identified by the Netherlands are:

– **Weak productive efficiency incentives:** Cost efficiency incentives for the production companies are weak. The four incumbents, through their cost pooling system which includes the costs of CHP, have extremely attenuated incentives for cost efficiency as they are able to pass through costs in prices. Thus, for example, the growth in CHP production ate away at the producers' market share, resulting in under-utilised capacity and higher unit production costs. These higher costs have been passed through to customers as higher prices.

– **Distorted generation entry:** Too much CHP investment forced SEP to limit output from plants which were economic on a short-term marginal cost basis (*i.e.*, baseload plants). Prices, which would fall in a market to adjust for over-capacity, instead rose to recover higher unit costs for SEP. Higher SEP prices in turn encouraged the distributors to develop more CHP, leading to less SEP output and a vicious circle of inefficiency.

– **Unwieldy central generation approvals process:** The central generation planning and approvals process for SEP required parliamentary and often judicial assent. This laborious process was inconsistent with the favourable approvals framework for CHP, and inconsistent with dynamic decision making needed for the production companies to compete in opening European market.

The inadequate separation of functions – generation and supply from transportation (transmission and distribution) and the related lack of end user choice – should also be emphasised. The cross ownership links between production and distribution combined with continued public ownership through the municipal/provincial governments add to this problem.

Third, efforts to liberalise electricity markets throughout the European Union (EU) were advancing, leading to the Directive adopted in December 1996 (see box below).

### Box 1. EU Directive on electricity liberalisation

The Council of the European Union adopted a directive on the internal market for electricity (EC, 96/92) on 19 December 1996 (EC, 1996). EU Member States must (with some limited exceptions) implement the directive into their national laws by 19 February 1999.

Under the directive, increasing shares of electricity markets must be opened to competition, based on size of user. For 1999, the group of largest users accounting for at least 26.48 per cent of the market must have a choice of supplier. This percentage increases to 28 per cent in 2000 and 35 per cent in 2003. In practice, the minima mean that only large users (average of 9 GWh annual consumption or greater – with a typical annual electricity bill of 500 000 euros or greater) would get the opportunity to choose suppliers (although Member States can or have gone further (*e.g.*, England and Wales, Sweden, Germany)).

Access to the grid is via a transmission services operator who must be separate (at least as a separate business unit) from generation and distribution businesses (distributors must have a distribution service operator who may be the same or not, as the transmission operator). EU Member States can choose from three different procedures for access. Under regulated third party access (as in England and Wales), the most liberal option, tariffs for third party access to the networks are regulated, published and are available to all parties. Under negotiated third party access (as in Germany), eligible consumers or generators/suppliers can negotiate network access with the incumbent utility. Prices and access terms are agreed freely among them and are confidential. The system operators must be involved in the negotiations and must publish an indicative range of transmission and distribution prices on an annual basis.

The third possible approach is the single buyer system, (so-called because a designated single buyer sells all electricity to final consumers) under which eligible consumers are free to conclude supply contracts with generators/suppliers both inside and outside the incumbent utility's territory. The single buyer purchases the electricity contracted by an eligible customer from a producer at a price which is equal to the sale price offered by the single buyer to eligible customers minus a tariff for network services.

There are two options for generating capacity additions. Under the tendering procedure, the monopoly utility determines when new capacity is required and conducts a tender for this requirement. Under the authorisation procedure, the timing of generating capacity investments is the responsibility of individual investors, provided that they meet criteria specified in advance by the Member State (*e.g.*, environment, land use, public safety) for grant of an authorisation to construct. Member States may also opt not to require a procedure and leave the addition to market forces.

The Directive contains significant provisions which may delay or affect the development of open markets. Member states may impose public service obligations to ensure "security, including security of supply, regularity, quality and price of supplies and … environmental protection". Furthermore, "to avoid imbalance in the opening of electricity markets" the directive permits the imposition of reciprocity requirements *i.e.*, a customer who has choice in one Member State may be prohibited from obtaining supply from a supplier in another Member State where customers of the same type do not have choice. The directive also permits Member States to impose a requirement that up to 15% of fuels to be used in the generation of electricity come from indigenous sources. A transitional regime for the recovery of stranded costs is also permitted, but must be approved by the Commission according to normal state aid rules.

Requirements for international trading or "wheeling" of electricity within the EU were originally set out in the Transit Directive (EC, 1990).

The Directive is to be reviewed with the intent of implementing further reforms 9 years after the original directive (*i.e.*, 19 December 2006). An implementation group has been set up by the European Commission to discuss how the directive will be implemented in Member States.

The EU has prepared a study that has examined the potential benefits of the liberalised market (EU, 1996). Cited benefits of increased international trade and competition include:

– Use of least cost plant across countries.

– Facilitation of trade with non-EU members.

– Reduced plant margin requirements (through interconnection and different peaking times).

– Optimal plant siting.

– More economic fuel choices.

– More efficient investment and operation of power plants.

Estimated savings are in the range of 10 billion ECU, which could mean wholesale price reductions across the EU of 5-11%.

### 2.2. New policy objectives: the 1995 White Paper

The new policy objectives for the sector were outlined in the government's Third White Paper on Energy Policy published in December 1995 (MEZ, 1995, hereafter White Paper). With respect to the electricity sector, there were three major themes:

*a)* Greater competition in the electricity sector is inevitable and desirable. The White Paper cites the International Energy Agency's Shared Goals that the creation of a free energy market is one of the basic principles for energy policy – provided that neither security of supply nor the environment is jeopardised as a result. It argues that changes in the European marketplace, demands of customers, and the problems with the existing structure all drive the government to undertake liberalisation of electricity (and natural gas) markets. The White Paper also argues that increased competition will produce a better match between suppliers and the needs of customers, competitive prices, and improved efficiency.

*b)* Sustainability and fuel diversification remain major objectives: The White Paper identifies long term policy objectives for the year 2020 to improve energy efficiency by one third and increase renewable energy supply from 1 per cent currently to 10 per cent by 2020. The government also expresses concern over the long-term vulnerability of the Netherlands economy because of its high reliance on natural gas – and identifies the promotion of renewable energy supplies as a means to diversify energy supply. With respect to electricity market liberalisation, the government acknowledges the need to ensure that environmental measures to ensure energy sustainability are consistent with liberalised markets.

*c)* Managing the transition to ensure a robust Dutch electricity industry is important: The White Paper makes clear that reform must not disadvantage the Dutch electricity sector – at least at the start. It argues that "it is advisable that the Dutch electricity industry starts off well equipped". The weak financial position of the Dutch production companies is highlighted and the paper argues that "large scale foreign utilities will be able to use their size and financial strength to seize parts of the Dutch market". More positively, the Paper anticipates new opportunities in Europe particularly in the marketing of CHP expertise and technologies.

The White Paper makes clear the importance of competition and reconciling energy markets with energy sustainability. However, the goal of ensuring a robust Dutch electricity industry has, in practice, been translated into an objective of protecting the four incumbent production companies during the transition. This is important. While the development of a competitive Dutch electricity generation sector can be promoted by removing barriers to entry, protecting existing incumbents softens the impact of reform. It is very important that any measures to soften this transition for the incumbents not unduly hamper competition and not create uncertainty that would reduce efficient entry by new entrants. However, as shall be seen in the following sections, this concern over the incumbents has had adverse impacts on reform and is likely to have an adverse impact on future performance of the sector.

### 2.3. Policy implementation: the 1998 Electricity Act

Table 3 summarises the key features of the 1998 Electricity Act and contrasts them with the previous legislation.

Table 3. **Comparison of the Dutch industry structure and regulation: impact of 1998 Electricity Act**

| Area | Old | New |
|---|---|---|
| Generation | *a)* Four generation/transmission (production) companies co-ordinated through SEP. CHP development by industries/distributors.<br>*b)* Parliamentary approval for new central generation. Few barriers for decentralised generation.<br>*c)* Central generation operation and planning of four production companies co-ordinated by SEP. Imports by SEP. | *a)* Four production companies to be separated. Numerous CHP plants in place as a result of 1989 Act.<br>*b)* Free entry for all domestic production to contract with distributors and eligible customers.<br>*c)* Reciprocity requirements on imports (see international trade). |
| Transmission | *a)* Transmission owned by the four production companies through ownership of SEP, who acts as system operator.<br>*b)* Transmission expansion requires Parliamentary/ judicial approval.<br>*c)* Postage stamp pricing for transmission.<br>*d)* Ancillary services pricing for decentralised generation. | *a)* Transmission assets of SEP jointly operated by independent network manager. Dutch government to hold 50% plus 1 of the shares. Oversight by independent governing board.<br>*b)* Non-discriminatory terms of access to the grid (transmission and distribution tariffs) regulated by network regulator and also approved by competition authority.<br>*c)* Postage stamp pricing.<br>*d)* Non-discriminatory ancillary services proposed.<br>*e)* Transmission investment plans reviewed by network regulator. |
| Distribution | *a)* Distribution and supply bundled in 23 municipal/ provincial public limited companies operating under monopoly concession.<br>*b)* Significant investment by distributors in CHP generation.<br>*c)* Number of distributors decreasing through mergers.<br>*d)* Distributors able to contract with generators other than the four production companies, but so far little incentive to do so. | *a)* Distribution services under independent distribution services operator. Oversight by independent board.<br>*b)* Merger activity continuing.<br>*c)* Non-discriminatory terms of access to the grid (transmission and distribution tariffs) regulated by network regulator and also approved by competition authority.<br>*d)* Distribution and supply operationally separated with independent boards.<br>*e)* Distributors able to contract with other generators. |
| Supply and end user choice | *a)* Distributors are also suppliers. No independent suppliers. Large customers able to import but few have done so.<br>*b)* Maximum customer tariffs approved by Ministry. | *a)* Customers able to contract freely according to size – large customers in 1999, medium 2002, small 2007.<br>*b)* Distributors licensed to act as exclusive, regulated suppliers for captive customers.<br>*c)* Prices for free customers unregulated.<br>*d)* Prices for captive customers regulated by Minister under license. |
| Regulator | Regulation carried out by Ministry of Economic Affairs. | *a)* New sector regulator (DTE) and competition authority (NMa). (DTE is a chamber of NMa).<br>*b)* Minister retains some regulatory responsibilities, notably setting tariffs for captive customers, imports, privatisation. |
| International trade | Central producers have monopoly through SEP. Very large customers (not distributors) can arrange imports. | Central producers able to continue existing import contracts. Customers/licensed suppliers able to purchase imports if reciprocal access available. |

Table 3. **Comparison of the Dutch industry structure and regulation: impact of 1998 Electricity Act** *(cont.)*

| Area | Old | New |
|---|---|---|
| Environment | *a)* Energy Efficiency programmes by distributors recovered through rates subsidies/green pricing of renewables. | *a)* Continuation of existing programmes.<br>*b)* New "green certificates" obligation on consumers to acquire renewable energy implemented through market mechanism. |
| Taxes and Subsidies | Utilities tax exempt, as publicly owned. CHP entry subsidised. | Tax exemption and explicit CHP subsidies removed. |
| Ownership | Municipal/provincial authorities own all central (and some CHP) generation, all transmission and distribution. Cross ownership links between production companies and distributors. | Unchanged. Law requires ministerial approval for privatisation prior to 2002. |

## 2.4. The Reform process

The success of reform is dependent on the transparency of the process (and hence its public acceptance), its comprehensiveness, its speed, and the robustness of the institutional framework supporting reform.

The Dutch electricity reform process has been slow. Discussions on the current electricity reforms were initiated by the government in 1993. The Third White Paper, released in late 1995, outlined nearly all the key elements of the new Electricity Law. This was supported by policy analysis by the Netherlands Bureau for Economic Policy Analysis (CPB) (an independent economic research arm of the government) which laid out the possible economic benefits to be achieved by market liberalisation in the electricity sector. A formal proposal for consultation "Current Lines" was released in July 1996 (MEZ, 1996*b*). The Minister's response to comments was tabled in the Parliament in November 1996 (Wijers, 1996).

Presentation of original legislation to the Lower Chamber, together with a summary of the results of the consultation, was made in September 1997. Passage by the Lower Chamber did not take place until 24 March 1998, causing the date of introduction of competition to be delayed by a year until 1999. Passage by the Upper Chamber occurred 30 June 1998.

In addition to the main legislation, the Dutch Government has produced secondary legislation on electricity reform, the *Electriciteitsbesluit* 1998 (NSL, 1998). This legislation contains many of the details concerning regulation of the high and low voltage networks. While this secondary legislation would normally have been approved at the same time as the law, the Dutch Parliament has decided that the items proposed to be regulated in the secondary legislation had to be regulated in the Act itself. Passage is now hoped for by July 1999. This delay will not affect the main legislation directly, but will mean that important regulatory details (*e.g.*, a legally binding open access transmission tariff) will not be in place until after the market is launched in January 1999.

The time taken from initial proposals to first phase of market opening is just over 3 years, not the quickest by international standards (*e.g.*, the State of Queensland, Australia had a market operating 16 months after the release of its White Paper (QERU, 1998)), but has moved rather quickly compared the slow Dutch norm (see the background report on Government Capacity to Assure High Quality Regulation). Furthermore, the legislation has benefited from the time taken to consult – both in terms of the high level of knowledge and sophistication about the reforms among the key market participants – and the clarity of the legislation.

The legislation has avoided the trap of overspecificity, a drawback which could unduly handicap further reforms as the market develops (a particular concern considering the length of time needed to pass legislation). However, the flexibility that results is a two edged sword because administrative discretion creates uncertainty. Thus while the Minister would be able to accelerate the pace of reform (*e.g.*, to

advance dates for customer choice) without further legislative changes, he could equally delay these dates. The decision by the government to delay passage of the secondary legislation will introduce some additional uncertainty.

As will be discussed later in the detail of the changes, the reform is not wholly comprehensive of the issues which need to be addressed (*e.g.*, effective separation of monopoly from competitive elements). In particular, there will be delay in opening up supply competition and in developing end user choice.

As regards the robustness of the new regulatory framework to promote competition, it is clearly a great step forward to establish a new competition authority and a new network regulator. However, the Minister's continuing role as a direct regulator on key issues (such as imports) may become an issue. There is also a need to ensure that the electricity market regulation is well co-ordinated with environmental regulation (covered by a different Ministry) and with gas market reform.

## 3. THE NEW MARKET STRUCTURE

The establishment of effective competition depends on a number of linked actions:

– The removal of any formal barriers to generation entry, action to mitigate informal difficulties, and the creation of a sustainable critical mass of generators, particularly in the mid to peak load sector where the wholesale price of electricity is set. Special attention needs to be paid to the market power of incumbents (*e.g.*, by promoting divestiture of generating capacity and action on long term capacity contracts). General competition policy has a key role to play in sustaining effective competition. Stranded generating costs must be addressed so as to minimise any incentive for incumbents with stranded assets to distort the emerging competitive playing field.

– Non-discriminatory and efficient access to and use of the transmission (high voltage) and distribution (low voltage) networks. Incumbent utilities usually control both the networks and most generating capacity. They can thus easily discriminate in favour of themselves. Ownership separation of generation and supply from the transportation function is the cleanest solution to prevent discrimination – there remains neither incentive nor ability to discriminate. Less stringent separation such as functional unbundling (where grid operation is managed separately from operation of generating plants) or accounting separation (where company accounts are ring fenced) require heavy – and possibly ineffective – regulatory oversight. An effective governance structure for the transportation networks, and the non-discriminatory, effective management of ancillary services are also very important. Finally, efficient network pricing and regulated access to the networks are key.

– The development of an effective wholesale market. Open, transparent markets for trading electricity, combined with a legal framework which facilitates direct bilateral contracting between customers and suppliers, forges a critical link between generation competition, competition in supply and end user choice.

– Effective generation competition must be mirrored ideally in the simultaneous development of competition in supply to end users and full end user choice. Reform should encourage direct contractual relationships between generators, suppliers and even end users. Ideally also, distribution (the low voltage physical transportation of electricity) should be separated from supply, so that supply competition is encouraged, creating effective choice for end users, additional to direct access through the wholesale market to generators.

– The evolution and liberalisation of the natural gas market may be a very important issue for electricity market liberalisation. Natural gas can have an important impact on electricity liberalisation, both as an input fuel to electricity and as competitor in end use markets.

– Finally, ownership and competitive neutrality are important elements to address. Private ownership is the most effective spur to efficiency, and if a mix of ownership remains, it is important to establish a level regulatory playing field for all companies (public and private) operating in the same market.

These issues are considered in more detail below in relation to the Netherlands.

### 3.1. Generation

Domestic generation competition is encouraged by the reforms up to a point. The new law will remove current formal barriers to entry in generation, and the requirement on the part of central producers to receive ministerial approval before starting a new plant. Whilst there is no specific provision to restructure the market, SEP will disband, leaving control with the four regional production companies, none of whom has more than a 20% share of the market. Also, the success of the policy to encourage cogeneration has already produced substantial decentralised capacity – by 2000 up to 40 per cent of Dutch electricity production will be produced from decentralised generation. Despite significant over-capacity and revised pricing rules (which has made CHP development less favourable than before) new CHP projects continue to be announced and it is expected to be the predominant form of new entry into the generation market for the foreseeable future (PiE, 1998*c*). Finally, there is substantial capability for importing electricity.

However, a new barrier to entry is being imposed on imported power. The extent to which customers can access imported sources is limited by the reciprocity requirements in the new Act. A customer who is eligible to choose suppliers is not permitted to import electricity from a country where he would not be eligible, without a dispensation from the Minister. For example, a Dutch customer in 2003 who consumes 100 kW (and therefore could choose among Dutch suppliers) would not be able to import power from a supplier in a neighbouring country if the laws of that country only permitted customers with demand above 1 MW to choose suppliers, unless the customer applied for and received dispensation from the Minister to do so.

The reciprocity provision, consistent with Article 19.5 of the EU Directive, is one of a number of measures in the legislation intended to protect the four Dutch generators against competing generators from other jurisdictions, particularly from jurisdictions with less open markets than the Dutch market. The Dutch market is interconnected with much larger electric utilities some of whom will be required to open their markets less quickly (in terms of size of customer).

An optimistic view of EU reciprocity provisions is that it could encourage a country with a less open market to liberalise further in order to gain access to a more liberal market. In North America, reciprocity requirements imposed by the US Federal Electricity Regulator (FERC) (despite national treatment provisions in the North American Free Trade Agreement) have forced Canadian utilities to undertake limited market liberalisation in order to gain access to the US market. However, a closer examination reveals that such utilities have liberalised only to the extent strictly required by the provision, and provided little scope for sales by US utilities into these markets. It is far more likely that various reciprocity provisions, imposed and interpreted differently by different states of the EU, could significantly dampen international electricity trade, reducing many of the expected efficiency gains across the EU from market liberalisation.

In a quest for fairness, the Dutch/EU reciprocity provision comes at a significant price by limiting an important source of competition for existing generators. This will weaken the incentives on the big four production companies to improve their performance. Less international trade will also reduce scope for savings from more efficient use of plant across countries and potential for reduced plant margins.

The optimal approach to this difficult issue has to be tackled at EU-wide level and in the context of developing and refining a consensus among all EU countries on a level of market opening which is shared by all. The next best solution, for increasing competition and reducing prices to Dutch electricity customers, is to drop the reciprocity requirement. A third best would be for the Minister to grant dispensations and to set high standards for withholding a dispensation. Furthermore, independent (*i.e.*, non-incumbent) power producers from other jurisdictions should readily receive dispensation for operating in the Dutch market.

These considerations are also important given the large import capability of the grid which could increase the contribution of imports from the already substantial 13% of electricity produced for Dutch consumption up to approximately 40 per cent. SEP is planning to enlarge this capability through an

undersea HVDC cable to Norway that is awaiting environmental approval (PiE, 1997*f*) – although this capacity will be used initially to fulfil a power contract between SEP and Statkraft.

There is no doubt about the potential for competition. There is a potentially very competitive generating sector (with access to low-cost natural gas and further CHP developments) that could attract investment in new generating facilities. The creation of a wholesale spot market, based on the Nordpool design, has the potential to provide a transparent pricing mechanism for electricity, encouraging trading of all types of capacity (baseload, mid-merit and peaking) through bilateral contracts. It also has the potential to stimulate an increase in the scope of the market beyond the Dutch national borders. The Dutch generating sector could become a highly successful competitor in international electricity trade and become net exporters, rather than importers, of electricity. Unfortunately, this potential is undermined by a number of government policies aimed at protecting existing incumbents. The reciprocity provisions discussed above will limit access of foreign producers to the Dutch market. Similarly, there is significant uncertainty currently over the government's policy to compensate the production companies for stranded costs (discussed below). This could have an adverse impact on new entry into the Dutch market.

### 3.2. Network access (transmission and distribution)

The aim of the new law is to ensure non-discriminatory access to the transmission and distribution grids through regulated third party access, the most liberal and transparent of the access procedures in the EU Directive. To achieve this, the generation and transmission activities of the production companies are to be operationally separated, and are put under control of an independent governing board, whose members must be approved by the Minister. Separation of the distribution network from the supply business of the distributors with an independent governing board is also mandated.

Furthermore, independent network managers are required for the national high voltage transmission network and for each distribution network. The network managers report to the independent governing board. Statutory duties of the network managers include:

– Operate and maintain the networks.
– Guarantee transport of electricity in a safe and reliable manner.
– Construct, repair and extend the networks.
– Publish plans regarding capacity needs for the networks.
– Maintain sufficient capacity.
– Offer connection and transportation (except where capacity is not available) and refrain from discrimination.
– Promote safe use of electricity.
– File open access tariffs.
– Maintain centralised system operation.

The network managers' authority includes the ability to refuse to transport electricity on technical grounds. Furthermore, generators and suppliers cannot interfere with the performance of the network managers' duties, giving the managers clear authority on the operation of the network.

Table 4. **Status of transmission business in OECD jurisdictions with reformed electricity sectors**

| Separate transmission company required | Separate transmission company not required |
|---|---|
| Australia (most states), Finland, Hungary, New Zealand, Norway, Spain, Sweden, United Kingdom (England and Wales only) | Germany, Italy, United States |

*Source:* Responses to OECD/IEA Electricity Indicators Questionnaire.

While the degree of separation is consistent with the EU directive, the decision of the Dutch Government not to require full structural separation of generation from transmission (*i.e.*, for generation and transmission to be in separate companies) is at odds with some other OECD countries that have reformed their sectors. Many OECD countries that have opted to introduce competition in generation have also opted for a separate transmission company to operate the grid system (see Table 4) in order to ensure non-discrimination. However, the recent agreement between the government and the utilities to give the national government 50% plus one shares in the national high voltage grid in return for recovery stranded costs diminishes this concern.

Nevertheless, it is not at all clear that the level of separation proposed in the Netherlands will be sufficient to ensure new entrants will have non-discriminatory access to the networks, particularly local distribution. Vertical integration of generation, distribution and supply has already started with the announcement that the distributor PNEM/Mega will reintegrate with EPZ, the generator of which it has majority ownership. A heavy burden will be placed on the new regulator to ensure that there is no cross subsidy between regulated and competitive businesses. Indeed, the government recognises that the degree of separation is not sufficient and has indicated that stronger separation measures may be implemented if discrimination proves to be a problem.

There is also the issue of what to do with the ownership of the national grid. Majority state ownership of the grid diminishes concerns about discrimination but raises concerns about the true independence of the grid regulator. An early privatisation of the grid would alleviate these concerns. The privatisation process should also provide incentives for the minority owners of the grid (the production companies) to tender their shares as well. In the United States, where private property rights make it impossible to impose divestiture, regulators in a number of states (California, Massachusetts, New Hampshire) have been able to persuade utilities to divest in order to remove this potential conflict. If it is considered undesirable or difficult to require out right separation, the US experience suggests that it may be possible for a regulator to persuade utilities owning generation, transmission and distribution assets to spin off their generating assets. A regulatory disincentive, *e.g.*, the threat of cumbersome regulatory oversight, may be helpful in encouraging this.

As noted above, the Netherlands has opted for postage-stamp pricing of transmission. New entrants will be obliged to pay for specific network expansions to connect them to the high voltage system (although not for consequent expansions in the main network). While postage-stamp pricing is in principle inefficient, the robustness of the existing high voltage system, the compact size of the country (and conversely, the potential for the market scope to increase far beyond Dutch national borders) suggests that a more complex approach to transmission pricing is not justified at this time. In future, as trading develops beyond Dutch borders into a regional market, the adoption of alternative approaches should be considered to deal with congestion.

Ancillary services are currently not separately priced. Proposals in the secondary legislation would improve efficiency, by ensuring that new entrants only pay for use of those services that they require (unlike the current system, where decentralised generation pays the same as centralised generation).

### 3.3. The development of a wholesale electricity market

Open transparent markets for trading electricity, combined with a legal framework which facilitates direct bilateral contracting between customers and suppliers, forges a critical link between generation competition, competition in supply and end user choice. An electricity market operator is needed to oversee the technical and economic operation of wholesale markets (and in particular, to oversee efficient behaviour by market participants) and, in some jurisdictions, plays an important role in system planning. Appropriate governance (and potentially, regulation) of the market operator are important to ensure non-discrimination among participants and efficiency.

As well as a spot market, parallel financial markets (such as forward markets and futures markets) can provide important hedging mechanisms, particularly for investors in power generation.

The Dutch electricity wholesale market is in the early stages of development. It will initially be a day-ahead market, based on the Scandinavian model (with some rule modifications to take account of the fact that Dutch generation is thermal rather than hydroelectric). Most trading is therefore expected to be through direct contracts between suppliers and customers, rather than through a centralised spot market (PiE, 1997*d*).

Plans are to introduce the day-ahead market when the market for large customers opens on 1 January 1999, with expansion to markets on the day, forward markets and futures exchanges as the market develops. As much of the electricity will be sold under contract in 1999-2000, the volume of electricity traded through the marketplace during this period will be a small proportion of the total electricity sales. The adoption of the successful Nordpool design to the Netherlands will likely facilitate the development of competition in generation and in supply for baseload, mid-merit and peaking generation.

A potentially important benefit of the creation of a wholesale market is to act as a catalyst for the Benelux region and beyond in regional trading in electricity. The Belgian utility Electrabel has signed up to participate in the Dutch exchange (EER, 1998). Regional wholesale markets encourage (indeed require) the development of compatible access rules and tariffs between countries. A planned interconnection between Norway and the Netherlands could also help encourage trading between Nordpool and the developing Netherlands wholesale market.

### 3.4. Supply and end user choice

Empowering consumers through choice of supplier is at the heart of creating effective and efficient energy markets. It is not enough to focus on upstream generation and grid access. Vigorous competition will only come about if there is also – as early as possible in the reform process – vigorous competition in supply to end users, and end user choice.

The 1998 Electricity Law opts for a phased approach for electricity consumers to choose suppliers. The first phase, based on customers with demand at any one site exceeding 2 MW, will include 650 customers (33 per cent of electricity sales). The second group of 54 000, with a connection to the network exceeding 3 x 80 A (about 50 kW), will have access/choice as of 1 January 2002 and will add another 29 per cent of sales. The remaining 7 million small business and household customers (38 per cent of sales) will have access as of 1 January 2007. These dates can be advanced or postponed at the Minister's discretion. Aggregation will not be permitted.

Customers without choice are referred to as "protected" customers in the law and will be supplied exclusively by the supply business of their local distributor. Supply accounts must be maintained separately from distribution network accounts.

Competition in supply will be quite limited until the end of the year 2000 because of the four-year supply contract (the Protocol) between SEP and the distributors. This Protocol means that supply for the protected customers will be purchased in the same way as before. Furthermore, a significant number of the initial 650 customers are themselves power generators under contract to the distributors.

While the reform goes beyond the minimum prescribed in the EU Directive (and many EU states) – notably in identifying a date where choice is to be extended to all customers – the date for this is already delayed for eight years and perhaps longer should the Minister decide to postpone. This long delay in empowering consumers is not necessary on technical grounds and appears to be a reluctance to extend the full benefits of liberalisation to small customers. The Dutch Government's decision can be contrasted with Germany, Norway, Sweden, New Zealand and some US states (*e.g.*, California, Massachusetts).

Moreover, the longer the phase-in period, the more likely that problems can arise, particularly if customers with choice can enjoy the benefits of price reductions in the liberalised markets but protected customers do not enjoy such gains. This has been observed by a number of jurisdictions phasing in by customer size. Long phase-in periods also increase uncertainty during the transition, effectively reducing incentives for generation and supply market entry.

Table 5. **Phase-in of competition in supply in OECD countries**

| No phase-in period | Juridictions requiring phase-in (and period) |
|---|---|
| Germany, New Zealand, Norway, Sweden, United States (some States) | Australia (3-6 years), United Kingdom (8 years) |

*Source:* Responses to OECD/IEA Electricity Indicators Questionnaire.

The adverse distributional effects of phasing in choice by customer size could be mitigated if customers were allowed to aggregate and purchase electricity co-operatively. Business organisations in the Netherlands which use multiple sites or co-operative organisations (such as the PBOs – see the background report on The Role of Competition Policy in Regulatory Reform) would welcome the opportunity to access cheaper sources of supply as would smaller businesses.

### 3.5. Natural gas market

Natural gas can have an important impact on electricity liberalisation both as an input fuel in electricity and as competitor in end-use markets. Natural gas and electric utilities/marketers, in turn, can be competitors in retailing "energy" rather than gas or electricity, suggesting opportunities for convergence between the two markets.

Netherlands energy policy places significant importance on the conservation of natural gas reserves, as natural gas is the only significant indigenous primary energy resource. The government will be liberalising their natural gas market to comply with the EU gas Directive. Market opening is expected to proceed on the same schedule as electricity for intermediate and small customers. The EU Directive specifies that all electricity producers will be able to choose their gas supplier as part of the first tranche of market opening – this will present natural gas-fired generation with an opportunity to further reduce costs.

However, the convergence between gas and electricity markets means that distortions in the structure and regulation of the natural gas market could lead to distortions in the electricity market. This is particularly important in the Dutch case because the electricity sector is very reliant on natural gas, the Dutch Government concerns with respect to natural gas security of supply, and the continuing involvement of the Dutch Government in the development and supply of natural gas through Gasunie.

The Government has historically relied on the 50 per cent state-owned natural gas company Gasunie[3] to ensure security of supply and to set prices. Currently, despite theoretical third party access provisions which would allow small fields to sell gas directly, (and since 1996, large consumers to buy gas) Gasunie, thanks to its effective monopoly transportation powers can buy gas at more attractive price than big industrial users could offer, and resells it to distributors acting as exclusive suppliers to end customers.

The Government's policy on natural gas liberalisation implies a continuing role for the government in ensuring adequate reserves of natural gas for domestic consumption. Gasunie will remain in place, but will offer access to its pipeline system on a negotiated (rather than regulated as in the electricity market) third party access system. The competition authority would have the responsibility of policing anticompetitive behaviour (such as abuses of dominance) by Gasunie but unlike electricity, there is no corresponding network regulator.

Gasunie is already a key supplier to the electricity producers – selling over 2 billion Dutch guilders (8.84 Mtoe at an average price of 252 Dfl./toe – IEA, 1998) worth of natural gas for electricity production (which in turn accounts for 60 per cent of all electricity supply). This compares to a price for large industry of 259 Dfl/toe and household prices (before tax) of 524 Dfl/toe.

Gasunie's position and less stringent requirements on unbundling and pipe access could give it an advantage if it chooses to enter the electricity market as either marketer (of both gas and electricity) or

as power producer. In other words, in the electricity market, Gasunie would be the dominant supplier of natural gas to power producers, could compete with those producers in supplying electricity through its own production, and compete with electricity marketers by marketing natural gas and electricity jointly. Competing marketers would be concerned whether Gasunie, through its non-transparent negotiated access provisions, might offer favourable transportation rates to its own marketing arm. Furthermore, as dominant supplier, it may be able to price discriminate between the more hotly contested large industrial market and the small customer market. Its competitors in the electricity generation business would be concerned about the prices they were being charged for natural gas and/or natural gas transportation compared to prices charged to Gasunie-owned generation (should it acquire any). While the competition authority has the responsibility to police Gasunie's transportation operations to ensure non-discrimination, there is a concern about the difficulty of successful enforcement if Gasunie is not restructured.

Similar concerns in the UK market with the introduction of competition led to a decision to separate the gas transportation and storage businesses of British Gas (now Transco) from that of natural gas production and marketing (now Centrica) (IEA, 1998*a*). To prevent Gasunie from abusing its position, it should be vertically disaggregated (ideally this should involve complete structural separation of transport from production, as in the UK), and third party access to transport should be regulated as in the case for electricity.

### 3.6. Ownership and competitive neutrality

Public ownership in the electricity sector is a major impediment to effective reform over the long run. Not only do the rigours of competition on a private company act as the most effective spur to efficiency, but it also forces companies to review their financing structure and publish company accounts that give shareholders clearer information about the company's profitability, financial structure (debt to equity ratio), return on capital, etc. It also ensures competitive neutrality within the market place with other private sector companies. Any continued public ownership in the sector, particularly in generation and supply, must be on the basis of competitive neutrality with private sector entrants. Publicly-owned utilities should therefore pay taxes at the same rate, have equivalent cost of capital and dividend policies, and generally be subject to an equivalent regulatory framework as private companies.

The Dutch public electricity sector is characterised by relatively high profitability relative to other electric utilities in other OECD countries, with significant dividends to shareholders (*i.e.*, the municipal/provincial councils) (OECD, 1997). However, these high dividends have been at the expense of improving the financial structure: typical debt to equity ratios are in the 80:20 range which could not be sustained by a privately owned company trading in the market. Such high ratios are indicative of the shareholders' confidence that the production companies would not be permitted to fail. Indeed, the government's action to encourage a merger of the companies is evidence that justifies shareholders' views. As a result, the production companies likely enjoy a lower cost of capital than a comparable privately-owned firm.

While such high ratios may be common in publicly-owned utilities, they are not in a competitive market. The production companies will require an equity infusion to reduce their debt loads, either from their existing shareholders or from a private sector partner, to be competitive in the new market. Such an infusion would also improve competitive neutrality.

The success of these companies depend on the sound business judgement of their management. Although they remain publicly owned, the boards of directors must be selected on the basis of business skills relevant to the new competitive market. Furthermore, these boards need to ensure their managements have proper incentives to maximise profits, minimise costs and to operate under hard budget constraints just as private sector firms.

As noted above however, better performance from management may be best achieved if shareholders considered privatising their assets. Unfortunately, the new law requires that ministerial

approval be obtained for the sale either of electricity production assets or the networks until the end of 2002 (the Minister can also opt to extend this requirement for the networks or suppliers until the end of 2006). This is bound to reduce the pressure on management to improve their efficiency.

Traditionally, neither the production companies nor the distribution businesses were required to pay corporate income tax as publicly owned companies. The Electricity Law provides for corporate taxes to be phased in gradually, over a ten-year period. This will be a significant positive step forward in establishing competitive neutrality. However, there could be a disincentive to privatisation because the privatised entity would become subject to full corporate taxes.

## 4. THE NEW REGULATORY FRAMEWORK

### 4.1. Objectives

The regulatory framework for a new competitive market structure needs to fulfil a number of functions. Not only must it provide for the effective development of a competitive market, but it must also find the most efficient way of integrating other objectives, notably environmental, safety, social and consumer protection objectives. The framework must also support the long term security and reliability of supply for electricity and deal with converging interests between electricity and gas regulation and electricity and competition regulation.

First, however, effective regulation of the new market structure (combined with robust regulatory institutions) is essential to ensure the development of competitive and efficient markets. Regulatory oversight is necessary in transportation, to ensure non-discriminatory tariffs and terms of access to the grid by all generators, suppliers and customers with choice. Effective transmission pricing is important in providing price signals to system users and encouraging appropriate and timely investment. In the Dutch case, regulatory oversight is also important to prevent cross-subsidisation between transportation and the competitive businesses of generation and supply.

The General Competition Law should be applied to the electricity sector except for those aspects which are covered by rules specific to the power sector.

The new Netherlands regulatory framework will be assessed in terms of its potential to underpin effective competition, followed by other key objectives such as the environment.

### 4.2. Regulation for an effective market

Electricity regulation will be carried out by three entities, a new network regulator (DTE), the (also new) competition authority (NMa), and the Minister directly.

***Network regulator (DTE)***

DTE will be a chamber of the Dutch Competition Authority, currently a supervisory department of the Ministry of Economic Affairs (although it is expected to become an independent administrative body in few years). It will regulate the transmission and distribution grids, including grid access prices and other terms of access, and will review plans for network expansion. However, as the market will commence operation before the secondary legislation is passed which sets out how DTE is to set prices and access terms and conditions, access prices and terms and conditions will be negotiated rather than regulated. The secondary legislation specifies that network tariffs are to be set according to a multi-year price cap (similar to the UK) (ESB, 1998).

Early challenges for the new regulator include:

– Cost allocation – to avoid cross subsidy between (monopoly) grid activities and the competitive activities of generation and supply.

– Transmission pricing and availability, particularly interconnections for imported electricity (as operational capability is far below technical capacity) – important in encouraging imports from other jurisdictions as an early source of competition.

– Pricing of ancillary services (including, notably, back up), particularly for CHP and for renewables – critical in ensuring effective entry over the medium term.

Good co-ordination is planned (and needed) between the network regulator and the new competition authority. DTE must have the agreement of NMa with respect to tariffs and rules for grid users. Furthermore, while DTE is part of the Ministry, it is expected that DTE staff will be physically located as a chamber within the NMa (Wijers, 1998).

***Competition authority (NMa)***

NMa, as well as general responsibilities to police anti-competitive behaviour by electricity market participants, has specific regulatory responsibilities identified by the new law. The general responsibilities of NMa include responsibilities to police mergers, horizontal and vertical agreements. All elements are relevant to the Dutch electricity sector – the proposed merger of the four production companies, the existing horizontal arrangements between the production companies, and the vertical arrangements between the production companies and the distributors. The specific responsibilities include:

– To review and reach agreement with the network regulator, DTE, on grid tariffs and access rules, from the competition point of view.

– Dispute resolution over grid access terms.

**Proposed merger of the generators:** The first case NMa decided to examine upon its creation in January 1998 was the proposed merger of the four production companies managed by SEP into a single new company "GPB". The merger was promoted by the Dutch Government as a necessary step to give the Dutch electricity generation sector the necessary size to cope with the opening of the European market. In effect, the Dutch Government is arguing that in a European electricity market, only the merged company would have the necessary economies of scale to compete. The Dutch Government (as noted earlier) appears potentially more concerned with national competitiveness, than with stimulating effective competition, at least in the early stages of reform.

NMa's initial examination concluded that the merger had significant potential for limiting competition in the new electricity market for the following reasons:

– The new company would generate the majority share of Dutch electricity.

– Over-capacity meant it was unlikely that much new generation would come on line in the Netherlands over the next few years.

– About 1 500 MW of the 4 000 MW import capacity would be controlled by the new single producer through existing contracts with foreign producers.

NMa's initial ruling would have meant the need to undertake more detailed investigation of the competition impacts of the merger. The second stage would have included an investigation of the claim that the benefits of economies of scale created by the merger would outweigh any adverse effects on competition. Even if NMa had ruled against the merger, the Government has authority to overrule NMa, and may well have done considering its policy position. However, shareholders of the four production companies subsequently decided not to proceed with the merger, reportedly because of a failure to reach agreement over governance and financial issues (PiE, 1998*b*).

There will certainly be significant competition benefits from four, rather than one, central producer because of the competitive pressures on electricity generation. Further, the collapse of the merger does not rule out new combinations of domestic and foreign producers that may, in the long run, enhance the value of Dutch electricity generating assets even more than the Dutch Government's proposal would have done.

**Horizontal agreements:** The 1989 Electricity Law required the four production companies to co-operate with one another through SEP (in effect, to act as a central generation pool). This co-operation included sharing information and common procurement of equipment and fuel. SEP was also responsible for existing import power purchase contracts and investments in coal gasification and renewable energy.

The decision not to proceed with the merger implies that these arrangements must be unwound, because they probably violate the Competition Law. The years of experience of the four production companies co-operating with one another may lead to some difficulties in changing their culture to one in which they must compete with one another. NMa will have an interest in examining any residual joint arrangements to ensure that the four companies have made this cultural shift to compete, and not to discriminate against new entrants.

**Vertical agreements:** Given the common ownership of generation, transmission and distribution, vertical agreements in the liberalised market will need to be carefully monitored. The competition implications of the recent agreement between EPZ and the large distributor PNEM/Mega (its majority shareholder), to reintegrate is a particular challenge. Also, the power supply agreement between SEP and the distributors, which runs to the end of the year 2000, will require exemption under the Competition Law. While the competition impact of this agreement is time limited, there is pressure to extend it. In fact, the Minister of Economic Affairs had argued that extension would aid the companies in the transition to competitive markets:

> *The gradualness with which the market is opened will give players (*i.e.*, generators and distributors) an opportunity, even after the expiry of the contract period (*i.e.*, end of 2000), to accomplish the transition to a totally free market by concluding long-term contracts. (*Wijers*, 1996).*

The ability of the competition authority to review these contracts is limited by the Minister's role in directly regulating the distributors' supply arrangements on behalf of protected customers, which is exempt from application of the Competition Law's prohibitions for a period of five years (NCA, 1998, (Articles 16, 107)).

### *Minister of Economic Affairs*

In addition to the role of DTE (the network regulator) and NMa (the competition authority), the Minister of Economic Affairs will continue to play a significant direct and indirect role in regulating the electricity sector.

The Minister's most important direct roles will be to regulate prices for the protected customers (*i.e.*, those with no choice of supplier), and to set out the terms and conditions of supply to these customers through a licensing process. Prices for supply are to be set through a multi-year price cap formula. As the Minister must "consider purposeful management by license holders in the purchase of electricity or fuels", this implies that anticipated changes in market prices could be reflected indirectly through the productivity factor. The Minister may also grant dispensations on a number of issues, most importantly on permitting imports by a customer from a country where a customer would not have a corresponding ability to choose a supplier (the reciprocity issue). Ministerial approval is also required over the privatisation of production or network assets up to the end of 2002, with the possibility of extending this requirement for the networks for four years.

The Minister also has significant indirect influence over the sector. With respect to DTE, the Minister can establish:

- Policy rules with respect to the exercise of DTE's authority.
- Network pricing policy (*e.g.*, "postage-stamp" pricing of transmission) and how investments in networks may be recovered through prices.
- Transmission planning requirements.

A fully independent regulator might have been more seriously considered. The Government's reluctance to introduce a fully independent regulator is, however, based on a bad experience with an independent regulator in the social security field (its financial mismanagement was blamed on the governing party costing it substantial support at the following election). The current arrangement leaves ultimate political accountability with the Minister. But the decision not to set up a fully independent regulator could have significant consequences. Given the Government's concern over the financial health of the incumbent companies, the Minister could use his/her regulatory powers to restrict imports (by use of the reciprocity article), and allow above market production costs to be passed through to customers (through the selection of the efficiency factor "X" in the price cap), to protect these incumbents. Once stranded cost recovery rules are in place and the incumbents are on a sounder financial footing, the establishment of a fully independent regulator should be reconsidered.

In any event, the Minister will face some difficult decisions as electricity regulator:

– **Regulation of retail prices for protected customers:** Setting the "X" factor in the price cap will be difficult, given that it is a multiyear cap but may not correspond to the most economic purchasing arrangement (which may be to rely on a portfolio of contracts of different durations). The reintegration of distributors with producers will make it more difficult for the Minister to determine whether supply agreements are truly economical.

– **Import regulation:** Rules governing the approval of imports from non-reciprocal jurisdictions will be a difficult challenge. How will the Minister regulate imports considering the number of times these could change hands? How will the arrangements work (as they need to) in the context of the wider role of the EU competition authorities and EU law?

– **Privatisation:** The requirement for Ministerial approval of asset sales up to 2002 appears to have been included because of the view that privatisation should only take place in a fully competitive market, not before. However, privatisation of generation assets could have clear financial and competition benefits for the sector. Private equity investment could be a solution to the high debt loads of the production companies. Outright privatisation could benefit competition by removing the common ownership interests between generators and distributor/suppliers, eliminating a source of potential cross-subsidisation, quantifying any stranded costs from generation investments and increasing competitors. Thus the government should be encouraging privatisation, rather than putting in measures to limit it.

### 4.3. Environmental regulation

The new Electricity Law effectively obliges much of the utility-committed activity in energy efficiency and renewable energy to continue. Measures include:

– Producers and suppliers are obliged to implement energy efficiency measures and are able to recover these costs through a levy on the networks (although this apparently will not be implemented).

– Suppliers are obliged to purchase small CHP, hydro, biomass under 2 MW and wind or solar under 8 MW until 2001 (or 600 kW until 31 December 2006) with payments to be set by the Minister.

The legislation also permits the Minister to impose a "green certificates" system to stimulate the production of renewable energy. Under this system, renewable energy producers are issued with certificates corresponding to their total contribution of renewable electricity to the Dutch market. The Minister creates a demand for these certificates by requiring all consumers to have the appropriate portion of certificates for their use (say 5 per cent of all electricity purchased). Electricity users (or their suppliers) may buy the certificates from the producers directly or purchase them through a market for the certificates (much as tradable emissions permits are traded). The trading price for the certificates should represent the marginal premium for renewable energy – providing a transparent price signal for potential entrants in the renewable energy market.

The green certificates proposal is commendable for its use of a market mechanism. By making the certificates tradable, it is possible to obtain a market price for the premium paid for green energy and put cost pressures on renewables producers.

However, it is a mandatory instrument that will create a separate "green" market, rather than an approach that seeks to integrate "green" with other electricity in one market. As with any market, green certificate prices could be very volatile, particularly if the Minister's target is set too high.[4] Verification of green production, particularly for foreign producers, will be an additional problem.

Renewable energy costs can be significantly affected by the electricity market rules. The secondary legislation is planned to ensure that the design of the market access rules, the pricing of ancillary services for intermittent sources of supply such as wind and solar energy, avoid unnecessary barriers or unjustified costs for smaller renewable sources.

Emissions regulation and policy will continue to be developed by the Ministry of Housing, Spatial Planning, and the Environment. Given the significant impacts of environmental regulation on the electricity sector, continuing close co-ordination between this Ministry and the Ministry of Economic Affairs will be needed.

### 4.4. Consumer protection

The Netherlands has a well-developed consumer protection system for small electricity consumers, not least because of a very well organised consumers association, the Consumentenbond. The *Stichting Geschillencommissies voor Consumenten Zaken* acts as a consumer complaints board, to deal with disputes between electricity distributors and small customers (CI, 1995). Mainly government funded initially, these boards are increasingly funded by the utilities.

In addition, the 1996 Energy Distribution Act (Wijers, 1996) requires the distributors to set up consumer councils which develop policies with respect to connection/disconnection, collection of unpaid bills, environmental policy, and information to be included in mailings to customers. The Consumentenbond and EnergieNed, the distributors association, have reached an agreement on a code of conduct which covers all areas including liability for power outages.

Both functions are to continue in the new marketplace. There is an opportunity to use these councils to assist in designing a market that will empower small consumers.

### 4.5. Social and other public service regulation

Electric utilities are often given additional service responsibilities that might not be voluntarily undertaken by competitive firms operating in a free market. These include local equality of tariffs (no cherry picking of good over bad customers) and universal local service. It could further include discounted electricity rates to certain groups, and service provision to rural or remote communities at prices below costs. The transition to markets must consider whether such obligations are still needed and, if they are to continue, their costs need to be made transparent and shared by all market participants. Subsidies should, to the extent possible, be applied through general funding, *e.g.*, lower or negative income tax rates, rather than by distorting market prices. If subsidies are applied directly to electricity, then they should apply to fixed costs and not to variable costs in order to minimise price distortions.

However, social obligations and subsidies do not appear to be an issue in the Netherlands. There appear to be no explicit subsidies to particular groups of users that need to be addressed in the Dutch reform.

### 4.6. Transition: stranded costs

The effective handling of transition – in particular stranded costs from an earlier regulatory regime – is fundamental to the success of market reform in order to ensure a level playing field for new entrants. Given the Dutch's Government's concern over the financial health of the four production companies, one

might expect an extensive stranded cost recovery framework. In fact, the stranded cost framework relied on the now-defunct merger of the production companies, leaving only limited provisions for stranded cost recovery in the legislation.

On the positive side, much of the central generation is by natural gas (which is locally abundant and generally sold through four year contracts) and coal (which is imported, and purchased competitively). Older assets have generally been upgraded both with respect to efficiency and emissions control; there is also significant investment by the producers in combined cycle gas-fired generation.

That said, four factors suggested difficulties ahead:

– A significant fall in electricity prices because of the move from monopoly to markets at the Dutch and European level, combined with substantial over-capacity in the European markets, creating downward pressure on prices.

– Past "public policy" investments that are now uncompetitive. This includes investments in district heating schemes and the coal gasification plant at Buggenum. These investments, amounting to 2 billion DFl (according to government estimates, PiE, 1998*a*) are uneconomic at current electricity prices, driven down by over-capacity and market reform.

– Contractual arrangements between distributors and industry on joint venture CHP investments. These joint venture projects often specify an electricity price for a 10-15 year period (this was necessary in order to procure favourable financing) at prices that may prove to be well above market prices. Similarly, some long-term fuel and power purchase contracts have been identified as potential stranded costs.

– The weak financial position of the production companies, with debt ratios in the 75-80 % range. The companies risk insolvency if prices fall in the market because of a lack of equity, since existing equity will be wiped out by the necessary write-off on the book value of the asset.

Two stranded cost recovery measures were established in the law:

– The four year supply agreement (until 31 December 2000) between SEP and the distributors requires the distributors to buy energy from the production companies at current prices.

– Stranded cost recovery mechanisms are specified in the new legislation. Until 31 December 2000, the production companies would be eligible for stranded cost recovery through a transmission levy. Furthermore, stranded costs from district heating schemes can be recovered through a transmission levy up until 2022.

In addition, the Netherlands government has reached an agreement with the companies on dealing with stranded costs. The main points of the agreement are:

– Stranded costs from investment in the coal gasification plant at Buggenum and specified urban heating projects will be recovered through the transport levies mentioned above.

– The Netherlands Government will take responsibility for any stranded costs arising as a result of long-term power contracts entered into by SEP.

– In return, the Netherlands Government will receive 50 per cent plus 1 share of the national high voltage grid assets of SEP.

– Furthermore, there will be no government support for stranded costs resulting from devaluation of normal production assets if the liberalisation process leads to substantially lower prices.

This agreement, which will require approval of the Dutch Parliament, is a very positive development for the Dutch electricity reform. It clarifies precisely what stranded costs will be recoverable and how they will be recovered from customers. By acquiring a 50 per cent share of the high voltage system, the government is enhancing separation between generation and transmission, further decreasing the likelihood of discrimination. By excluding the fall in value of assets as a consequence of liberalisation, it sets a very high standard of what costs ought to be recoverable and thus will encourage financial restructuring (and possibly privatisation) of the production companies.

However, some distributors are very concerned that there are no stranded cost recovery provisions for their CHP ventures and they may seek to recover any excess costs through prices charged to the captive customers. The Minister, as regulator, will need to guard against attempts by the utilities to recover these costs through supply charges on captive customers.

## 5. PERFORMANCE

As the Netherlands is just beginning its market liberalisation, the performance measures below must be seen as benchmarks against which future performance can be measured. At this stage in international market reform of electricity, there is also little data for international comparison. It is not therefore clear how the Netherlands compares with others. Some studies have been carried out to estimate potential gains, as discussed in Box 2.

### 5.1. Costs and productivity

**Labour productivity:** The Netherlands reports a significant improvement in productivity from the public supply system (SEP plus the 23 distributors) from 3.0 GWh per employee in 1994 to approximately 4.2 GWh per employee in 1997 because of downsizing in both generation and network businesses. The management of the production companies had developed a plan to improve efficiency as a single production company, suggesting that staff could be reduced by a further 25% (from 5 300 to 3 800)(PiE, 1997*a*). While some of these savings were likely only achievable through the merger, the pressure to find savings of similar scope will continue once the competitive market is launched. This suggests that the OECD analysis (see Box 2) which forecasts an improvement in labour productivity under liberalisation from 3.0 to 4.5 GWh per employee may be an underestimate. The Dutch Bureau of Economic Policy Analysis (CPB) has initiated research in this area (Dykstra, 1997). Hopefully, this will also shed light on the type of activities that are expected to yield most efficiency gains (and whether some of the efficiency gains are due to outsourcing).

**Fuel conversion efficiency:** Efficiency of fossil fuel conversion to electricity in electricity production facilities is relatively high in the Netherlands at 44 per cent (fossil fuel only). This high percentage is due to the large proportion of CHP as well as recent investments by SEP to upgrade efficiency at existing plant and to build a new combined cycle station at Eemshaven.

**Investment efficiency:** There is continuing over-capacity in the Dutch generating sectors because of continuing investment in CHP. Total capacity in 1997 was nearly 20 000 MW with a peak demand of less than 15 000 MW (including load displacement) – leaving a reserve margin of approximately 33% – far greater than necessary. This also does not include the impact of imported electricity – about 1 500 MW is currently under contract to SEP – which takes the excess even higher.

The key for improved investment productivity will be realised through plans to close down older and less efficient power plants (a practice that will be strongly encouraged by market pricing) as well as finding new markets in which to sell electricity, a task made more difficult by current European overcapacity. Nevertheless, provided the EU Directive is successful in providing new opportunities for Dutch generators to sell electricity, Dutch generators could reduce reliance on imports and might even aim, over the medium term, to become exporters of electricity.

### 5.2. Prices

IEA data rank Netherlands electricity prices for both industrial and household consumers in the middle of the pack among IEA countries (see Figure 1, IEA 1998). It should be noted, however, that international price comparisons may be misleading, as we may not be comparing "like with like". For example, some countries' electricity prices may be distorted by subsidies and cross subsidies between consumer groups. Also, the financial position of companies across countries is not easily comparable and may lead to price differences that are unrelated to real efficiency and costs.

### 5.3. Reliability

Like the rest of Western Europe, reliability of electricity supply is very high (26 annual minutes of unavailability per customer per year).

### 5.4. Environmental performance

Emissions of sulphur and nitrogen oxides from the central generator SEP have fallen principally as a consequence of emissions control equipment (flue gas desulphurisation, selective catalytic reduction) added to coal-fired generation, installed as result of a covenant between the producers and the national and provincial governments covering the period 1990-2000 (UNI, 1997). Since 1990, total emissions of sulphur oxides have fallen 66 per cent and NOx have fallen from approximately 33 per cent. Emissions intensity has declined to 0.18 g/kWh and 0.6 g/kWh in 1996 (a very low figure for an OECD country relying so heavily on fossil fuels for power generation). Carbon dioxide emissions from electricity production have increased 8 per cent since 1990 – owing in large part to a rise in production of 20 per cent. Carbon dioxide emissions intensity has fallen to 0.5 kg/kWh. as the increase in production is largely CHP and combined cycle gas power generation. The Netherlands Kyoto target (a 6 per cent reduction of greenhouse gas emissions from 1990 levels over the period 2008-2012) will be difficult to achieve. On the positive side, however, over-capacity, low demand growth and new renewable energy coming on stream could help the process.

Box 2. **Forecast benefits of electricity market liberalisation**

A study commissioned by the OECD (OECD, 1997) noted that labour productivity in the Netherlands was low, lagging well behind the United States. Significant surplus capacity (although common among utilities) also implied that capital productivity was suboptimal. The study cites other work that suggests public utility worker pay was higher than workers in comparable industries.

The analysis develops a base scenario on the impact of market liberalisation: a 50% improvement in labour productivity, a 5% reduction in wages and profits, a 25% cut in capital costs and a 5% boost in output from increased innovation. The analysis predicts an 11% reduction in prices and a 5.7% boost in output. Given the total turnover for the sector of about 12 billion DFl, an 11 % price reduction represents reduction in costs for consumers of 1.3 billion guilders per annum. There is, however, a 25% employment loss in the sector from the efficiency improvements.

## 6. CONCLUSIONS AND RECOMMENDATIONS

This review of the Netherlands electricity reform is prospective, as the reforms are just being put into place and many of the detailed rules have yet to be finalised. This report therefore focuses on the overall design of the reform, and identifies areas in which reform could be strengthened.

### 6.1. Conclusions

The Netherlands electricity reform has many strengths. Objectives have been clear and fit in with the larger program of reform. There has been a good deal of consultation with future market participants, and the legislation itself is clear.

Other strengths relate to the design of the reform itself. As discussed above, this includes:

*a)* **Good potential for competition in generation** because of the large number of generators and substantial import capability and transfer of majority ownership of the high voltage network to the national government.

*b)* **The development of an electricity exchange based on the Nordpool design** is important in stimulating the whole market, notably supply, as well as generation. It may also encourage the development of regional exchanges in continental Europe. (International participation in this exchange is the first stage in creating a regional market).

*c)* **Good co-ordination between the network regulator and the competition authority** appears to be in place with respect to terms and conditions of access to the networks. The commitment to a price-caps approach should help enhance efficiency of the utilities.

*d)* **Stranded costs** are to be dealt with transparently, and set a very good basis for recovery by excluding the fall in value of generating assets from being eligible for recovery.

*e)* **A level playing field for taxation** of publicly-owned companies will help ensure efficient entry into the generation market.

*f)* **The green certificates programs for renewables** is an attempt to find a transparent market-based mechanism for the development of renewable resources.

*g)* **Consumer protection** institutions are in place to assist the transition of small consumers into the market.

Despite the above, there are several weaknesses in the Dutch electricity sector reform which will impede the future development of the Dutch electricity market:

*a)* **Delays in implementing the secondary legislation** will delay implementation of the new network pricing and access terms thereby increasing uncertainty and hence new market entry.

*b)* **Separation of the networks from the competitive activities** of generation and supply, is less than ideal. Continued common ownership of central generation, transmission and distribution, the limited degree of separation of distribution from generation or supply will require heavy and, possibly, ineffective regulatory oversight.

*c)* **Delay in extending end user choice.** The relatively long period before all end users have choice and the decision not to permit customers, in the meantime, to aggregate and purchase power collectively is a significant lost opportunity for accelerating choice, increasing competitive pressures on incumbent suppliers and encouraging new suppliers. Also, the contractual arrangements between generators/suppliers and distribution companies will add to the problem.

*d)* **Reciprocity requirements.** While consistent with the EU directive and the need for an adjustment period by the four (relatively small) production companies, reciprocity requirements weaken competitive price signals. Furthermore, it threatens to undermine expansion of trading over the region.

*e)* **Privatisation limits** by the Minister on the grounds that private companies would be inheriting monopolies do not support the potential for competition in generation and supply and discount the significant financial and competitive benefits that privatisation could bring to the sector.

*f)* **The Minister's direct role** in regulating supply prices for protected customers, controlling imports and sale of system assets and the immunity of such decisions from the competition authority, give scope for ministerial decisions to be at variance with increasing competition.

Limited structural change in the natural gas market liberalisation could give Gasunie an unfair competitive advantage in electricity markets, distorting competition between retailers in energy end-use markets. The lack of regulated TPA for gas is also a concern because of the potential for problems with non-discriminatory access to competitive gas sources by power producers.

### 6.2. Recommendations

The recent passage of the new Electricity Act should ensure the main features of the legislation are implemented on time to comply with the EU directive. The decision to delay the passage of the secondary legislation will mean that implementation of significant regulatory details will be delayed. Therefore, *the Netherlands should ensure that the new Electricity Act and accompanying secondary legislation are implemented as soon as possible and without further delay.*

While the framework for electricity market liberalisation is in place, the Government will be undertaking natural gas market liberalisation pursuant to the EU gas directive, which involves less stringent separation of Gasunie's production and transportation businesses. The potential market power of Gasunie in the converging natural gas and electricity markets is of concern. Therefore, *the natural gas sector should be restructured to the same extend and regulated in the same manner (by the same regulators DTE and NMa) as electricity.*

Under the new law, the Minister retains authority for many sector regulatory activities, particularly the regulation of supply tariffs. Regulatory decision making should be independent from commercial and day to day political pressures. Therefore, *the new regulator and/or competition authority should, as soon as possible, take over the Minister's regulatory responsibilities.*

The transition to effective competition is supported by separating the potentially competitive activities from the networks, and restructuring to reduce the market power of incumbents. The continued cross ownership of generation and transmission by the four production companies remains a concern, albeit reduced by the government acquisition of a majority share of high voltage transmission. Similarly, the continued single ownership of distribution and supply functions is a concern. Therefore, *the new network regulator, DTE, should apply requirements for vertical separation stringently so that owners of network assets are encouraged to spin off and/or privatise their generating assets or remaining transmission shares, monitor closely the unbundling requirement on distribution and supply, and seek opportunities to encourage early review of these arrangements, notably separation through privatisation.*

Competition law needs to be enforced vigorously where collusive behaviour, abuse of dominant position, or anticompetitive merger risk frustrating reform. Sector reorganisation is already leading to new vertical reintegration between generation and distribution/supply. A particular concern is supply tariffs for captive customers, regulated by the Minister, where vertical arrangements may lead to arrangements that lead to purchases of electricity at prices that may be above those available to liberalised customers. Therefore, *any vertical arrangements must be made subject to competition authority review.*

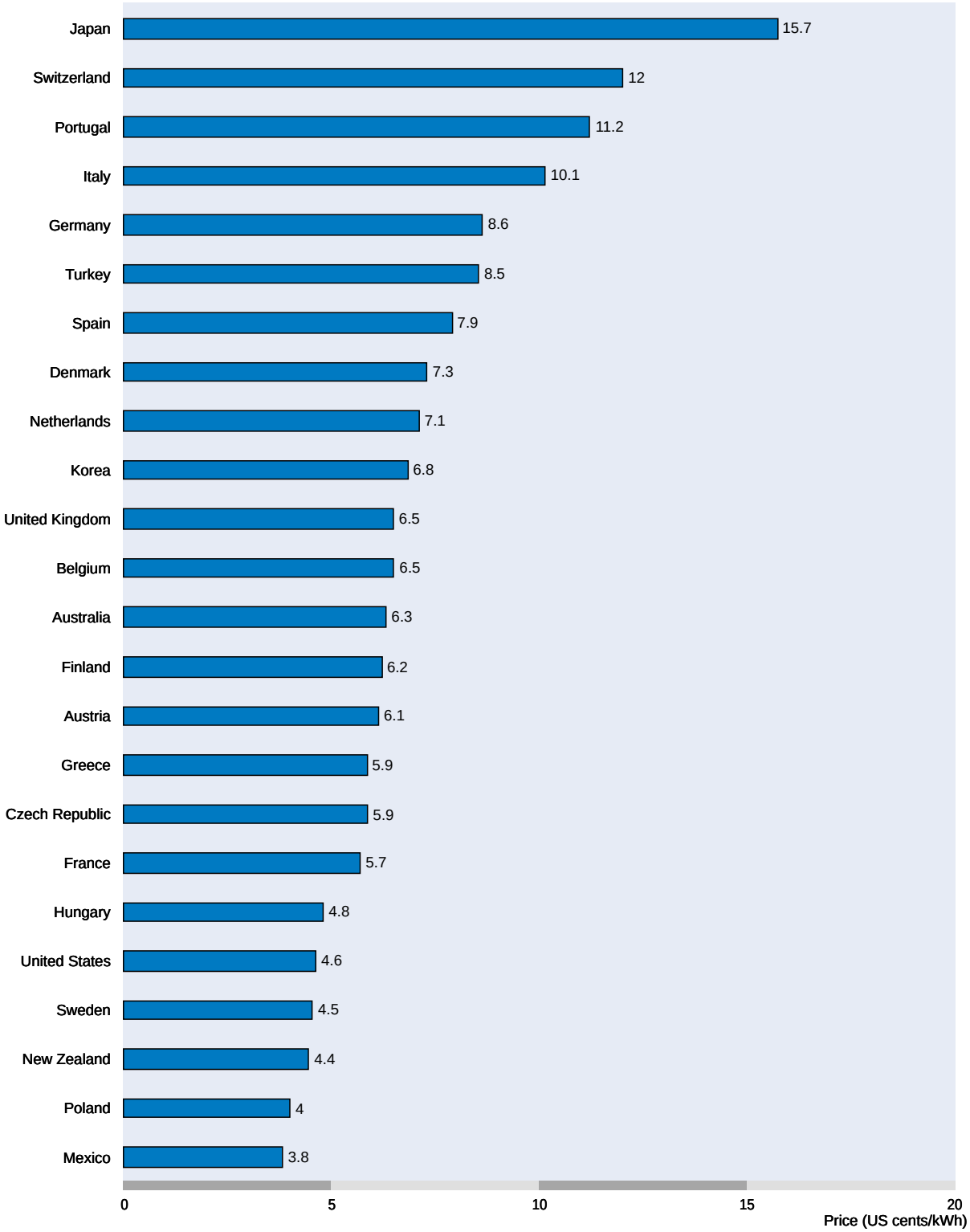
The lengthy transition period in the Dutch reform process and the limitations on aggregation of purchases are unnecessary barriers to the rapid introduction of vigorous competition. Therefore, *the regulator should immediately require that access rules permit small customers to aggregate to prepare utilities and customers for the retail market; and the timetable for the introduction of full choice to all consumers should be advanced as quickly as practicable.*

The reciprocity restrictions, if applied too broadly, could deprive the Dutch market of an important efficiency incentive in the early years of the market. Therefore, *restrictions on imports should be applied sparingly, if at all.*

While the Dutch legislation is fully compliant with EU legislation, the potential efficiency gains in the Dutch market will only be realised if the market expands beyond Dutch borders. Therefore, *the regulator should encourage the development of compatible transmission access rules, market operations, contract terms and tariffs between the Netherlands and neighbouring electricity systems.*

Figure 1. **1996 electricity prices in OECD countries**

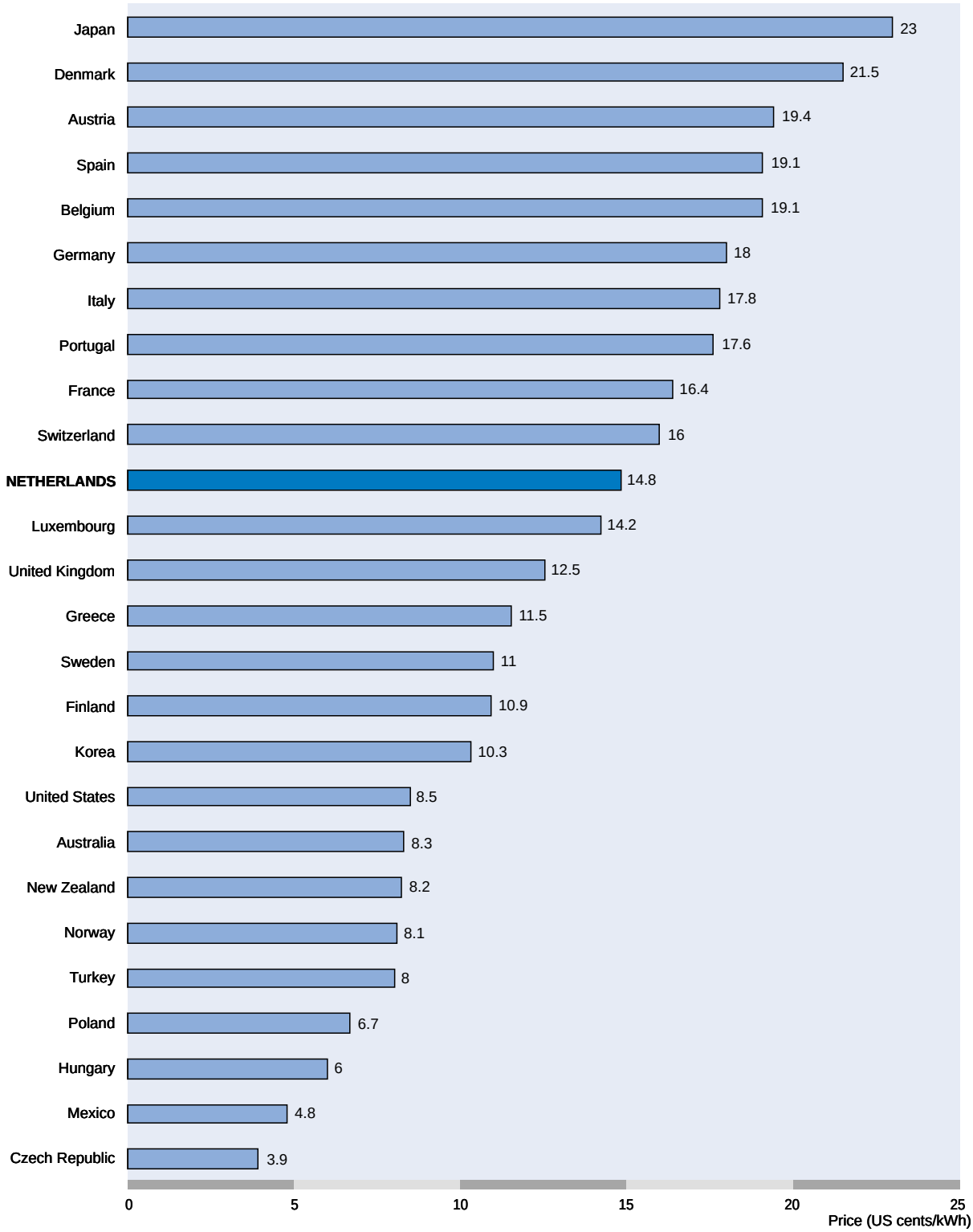
**Industry**




*Source:* IEA, 1998.

Figure 2. **1996 electricity prices in OECD countries**

**Households**




*Source:* IEA, 1998.

# NOTES

1. Throughout this paper, production companies refers to the four companies that own generation and high voltage transmission.
2. Under the third Environmental Action Plan proposals, released in February 1998, the government is proposing to double the REB in order to encourage increased conservation and to use a portion of revenues raised (500 million Dfl) to stimulate energy efficiency and renewable energy (VROM, 1998).
3. Gasunie is 50 per cent state owned (10% directly, 40% through a holding company), with Shell and Esso each holding 25% shares.
4. For example, if a major renewable project was delayed, this could lead to an unexpected scarcity of certificates given the lead-time for renewables projects. This problem could be compounded if all green certificates had to be handed over on a particular date. There are different techniques to mitigate these effects, such as permitting banking of certificates (*i.e.*, allowing unused certificates to be used in future years), having the Minister hold back a certain percentage of certificates, or futures markets in the certificates (provided there was sufficient liquidity to support this).

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# BACKGROUND REPORT ON REGULATORY REFORM IN THE TELECOMMUNICATIONS INDUSTRY*

* This report was principally prepared by **Wonki Min** with the participation of **Dimitri Ypsilanti** of the Directorate on Science, Technology, and Industry. It has benefited from extensive comments provided by colleagues throughout the OECD Secretariat, by the Government of the Netherlands, and by Member countries as part of the peer review process. This report was peer reviewed in September 1998 by the OECD's Working Party on Telecommunication and Information Services Policies and by the Competition Law and Policy Committee.

# TABLE OF CONTENTS

## Executive Summary

## Background Report on Regulatory Reform in the Telecommunications Industry

The telecommunications industry has undergone significant regulatory reform over the last decade. By December 1998, 23 of the OECD countries had unrestricted market access to all forms of telecommunications market, including voice telephony, infrastructure investment and investment by foreign enterprises. The success of the liberalisation process depends on the presence of a transparent and effective regulatory regime that enables the development of full competition, while efficiently protecting other public interests. This report addresses whether the regulatory regime in the Netherlands can ensure the success of the liberalisation process by assessing the Dutch telecommunications regulations, recent regulatory reforms and market performance.

Telecommunications liberalisation in the Netherlands is in line with the European Commission's efforts to liberalise the European telecommunications market. In most important policy issues such as interconnection, licensing, universal service, etc., EU Directives have played a key role. At the time of writing the Netherlands has implemented virtually all EU Directives into national legislation.

The new Dutch telecommunications regime is relatively liberal, with no barriers to entry, no line-of-business restrictions and relatively few controls on prices. In the relatively short time since deregulation a large number of companies have entered the market, invested in facilities and are providing telecommunications services. Although, at present, the incumbent operator remains overwhelmingly dominant, the possibility of infrastructure competition through the virtually ubiquitous CATV networks and the possibility of strong competition from mobile services means that, in practice, there are relatively few concerns about the development of effective competition in the near future.

However, certain regulatory concerns remain such as the fact that there are different regulatory institutions for telecommunications and broadcasting services. In the longer term, the rapid convergence taking place between broadcasting, Internet and telecommunications is likely to increase the necessity to establish a regulator which supervises all the communications industry. The Netherlands, like most OECD countries, is facing a double challenge: to complete the liberalisation of the telecommunications market, and to prepare for the next generation regulatory regime in the face of convergence.

# 1. THE TELECOMMUNICATIONS SECTOR IN THE NETHERLANDS

## 1.1. The national context for telecommunications policies

The Netherlands is a small, densely populated country at the heart of Europe. Its population density of 379 per square kilometre is one of the highest in Europe (and compares with 229 in Germany, 105 in France, and just 29 in the USA). Of the total population of 15.5 million, a little under half live in a single urban zone known as the "Randstad" which incorporates all of the Netherlands major cities. The telecommunications market in the Netherlands brings in a total revenue of around $7.9 billion, making this market smaller than a typical American RBOC and comparable in total size to that of Korea ($9.1 billion), Mexico ($7.7 billion) and Sweden ($6.9 billion).[1]

As of 31 December 1997, the total penetration of telecommunications access paths in the Netherlands (*i.e.*, the total number of fixed access lines and mobile lines per 100 inhabitants) was 56.6. This compares with that of Germany (55.0), France (57.6), and the UK (54.0). The total cable television (CATV) penetration in the Netherlands (at 93.14 per cent) is one of the highest among the OECD countries (comparing with just 46.19 per cent in Germany, 8.97 per cent in France and 9.69 per cent in the UK).[2]

The incumbent network operator, KPN, with a total staff of 32 708 is the 19th largest telecommunications operator in the OECD area. KPN completely digitalised its network by 1994 earlier than any other operator in the OECD area and now enjoys one of the highest labour productivity (at 271 mainlines per employee) among the operators in the OECD area.[3]

## 1.2. General features of the regulatory regime, telecommunications market and market participants

### *The role of the EU*

The reform of telecommunications markets in continental Europe has essentially been driven by the European Union (EU) policies. Since the release of the 1987 "*Green Paper on the Development of the Common Market for Telecommunications and Services*", the European Commission has played an important role in promoting the liberalisation of the EU telecommunication market. This culminated in the Full Competition Directive which was designed to open the EU telecommunication market to full competition by 1 January 1998.

EU Directives are meant to provide a broad framework and general objectives, as opposed to detailed prescriptions, as to how policies should be implemented. Member states therefore have considerable freedom in determining the details of each national regulatory regime. Although in some respects the Netherlands had been late in meeting the implementation deadline on some of these directives,[4] with the new Telecommunications Act (the "Act") it has implemented all the EU's Directives into its national legislation.

### *Brief history of the regime*

Prior to 1990, the Royal Dutch PTT (KPN) held a monopoly on all aspects of the installation of telecommunications networks and on the provision of all telecommunications services. Over the next 7 years the market was progressively liberalised, culminating in an opening of the market to all forms of competition in voice telephony on 1 July 1997.

A brief summary of the key developments in the liberalisation process is set out in the Box 1. In 1989, a decision was taken to begin the corporatisation of KPN, and to liberalise the markets for terminal equipment and value added services. In 1993, competition was allowed for circuit and packet switched data transport services, and simple resale of leased line capacity. In 1994, voice telephony service in closed user groups was permitted. At the same time, KPN was partially privatised with a sale of 30 per cent of the government's shares.

Prior to 1994 KPN held a monopoly on the provision of analogue mobile services. In 1995, two new licences for digital GSM mobile services were issued, one to KPN and one to a new entrant, Libertel. Libertel is jointly owned by the Dutch financial giant ING Group and the English mobile service provider Vodafone.

Box 1. **History of telecommunications liberalisation in the Netherlands**

- 1989: Corporatisation of KPN and liberalisation of terminal equipment and value added services.
- 1993: Liberalisation of data communication services and resale of leased lines.
- 1994: Partial privatisation of KPN (involving a sale of 30 per cent of the shares); voice telephony in closed user groups permitted.
- 1995: Issuing of licences in mobile services, to KPN and Libertel; further sale of 25 per cent of the shares of KPN.
- 1996: Liberalisation of telecommunications infrastructure and liberalisation of all telecommunications services except fixed voice telephony.
- 1997: Liberalisation of voice telephony (1 July) and establishment of an independent regulator (1 August).
- 1998: Issuing of 2 (and possibly 3) new national mobile (DCS1800) licences.

In 1996, the Netherlands introduced the so-called "interim legislation".[5] This legislation allows competition (except for voice telephony) for satellite networks and communications services, use of cable television infrastructure for telecommunications purposes, use of other alternative fixed infrastructure (*e.g.*, networks of electricity companies and the railway company) for telecommunications purposes and the installation and exploitation of new fixed telecommunications infrastructures. In July 1997, six months earlier than scheduled by EU legislation, competition for voice telephony service was introduced in the Netherlands, completing the liberalisation of the whole telecommunications market.

In 1996, on the basis of the interim legislation, two new national infrastructure licences were granted, to EnerTel (a joint venture of several Dutch electricity companies and several cable operators, acquired by Worldport Communication Inc. in June 1998), and to Telfort (a joint venture of NS Telecom, which is a subsidiary of Dutch Railways and BT). Both companies already had alternative telecommunications infrastructure. It is interesting to note that the state has a significant stake in two national telecommunication infrastructure licensees. In addition to the direct 43.8 per cent state ownership in KPN, the state owns 100 per cent of the Dutch Railways (a major shareholder in Telfort). Moreover, prior to 1997, KPN owned Casema, the largest shareholder of EnerTel. This gave rise to concerns over the extent to which competition would arise between KPN and EnerTel. To address these concerns and stimulate the development of alternate infrastructure, in 1997 the Dutch government required KPN to divest its ownership in Casema.

As well as these national infrastructure licences, in 1997 about 1 400 regional infrastructure licences were awarded to approximately 160 companies. In most cases these companies already held permits for CATV or business networks.

In October 1998, the interim legislation was replaced by the Act which aims at ensuring full competition in all telecommunications activities and complete implementation of the EU ONP principles.[6] The Act was originally planned to be enacted by 1 January 1998. However it took 10 more months to finalise the legislative process than was planned. The Act includes a number of new regulatory provisions and safeguards to prevent the incumbent from leveraging its dominant market position. The Act foresees the government (including the independent regulatory body) remaining as a key player in the market until it can be shown that the market or specific segments of the market are sufficiently competitive to allow the government to forebear from regulation.

The Act covers practically all areas of telecommunications regulation, including registration, spectrum frequency policy and management, numbering policy, rights of way, interconnection and special access, open network provision (ONP), universal service, type approval of terminal equipment, protection of personal data and privacy, and disputes and appeal processes among telecommunication service providers.

In February 1998, two additional national licences consisting of a combination of 15 MHz DCS 1 800 (Digital Communications System) frequencies and 5 MHz GSM business were allocated to Federa (which is the tentative working name of a consortium of Deutsche Telkom/France Telecom/ABN-Amro/ Rabobank) and Telfort. Notably, the existing GSM licence holders, KPN and Libertel, were excluded from bidding for these licences. Sixteen smaller DCS 1 800 packages were also awarded.

The Dutch CATV industry is potentially a strong source of competition for the local loop. Virtually 100 per cent of households are passed by cable networks in the Netherlands and about 94 per cent are connected to cable networks. Under the interim legislation, CATV companies are allowed to use these networks for telecommunications purposes.

While CATV companies have considerable potential as alternative telecommunication infrastructure providers, not many companies have entered the telecommunications market yet. This is probably due to the huge investment which is necessary to upgrade their cable infrastructure in order to provide two-way telecommunications. However, big players like Casema, Castel, Edon and A2000 have made significant investments in order to provide integrated services including CATV, FM radio, Internet access, data communication and local voice telephony. It is expected that 70 per cent of the cable network will be suitable for two way communication by 1999 and 85 per cent by 2000.[7] With the exception of A2000 which launched its voice telephony service in November 1997, other cable companies have been more interested in providing Internet access. But currently only five cable CATV companies have interconnection agreements.

### *Telecommunications market and participants*

The current situation in the Dutch telecommunications market is summarised in Table 1. As the table indicates, KPN has a dominant position in all of the major telecommunications markets. KPN provides both fixed and mobile voice telephony services and once owned the largest cable company Casema. KPN is also a partner of Unisource, the pan-European telecommunications company, which was established in 1992 by KPN and Telia of Sweden.[8]

Table 1. **Major participants in the Dutch telecommunications market**

| | Fixed | Mobile | Internet | Notes |
|---|---|---|---|---|
| **KPN** | A<br>Local: 99%<br>Long Distance & International: 80% | A<br>Analogue: 100%<br>GSM: 63.5% | A | |
| **Telfort** | A | P (DCS 1800) | | Providing value added services such as calling card, e-mail, voice mail and VPN |
| **Enertel** | A | | A | Targeting top 300 companies in the Netherlands |
| **Libertel** | | A<br>GSM: 36.5% | | |
| **Federa** | | P (DCS 1800) | | A consortium of Deutsche Telekom/ France Telecom/ABN-Amro/Robobank |
| **TeleDanmark** | | P (DCS 1800) | | Trying to build a nation-wide network in co-operation with Orange/Veba |
| **A 2000** | A | | A | |
| **Worldcom** | A | | A | |
| **Edon** | A | | A | Providing fixed voice telephony services via ISDN |
| **Casema/PNEM/ NUON** | P | | A | Casema is the largest cable company with 1.06 million subscribers as of 1 January 1998 |

A = Currently Active, P = Planned to enter.
*Source:* OECD.

Table 2. **Dutch telecommunications regulation at-a-glance**

| Category | Regulatory restrictions | Notes |
|---|---|---|
| **Entry regulations** | | |
| Voice telephony | Entry on the basis of registration with OPTA. | |
| Leased lines | Entry on the basis of registration with OPTA. | |
| Mobile telephony | Entry on the basis of "individual licences". An auction is used for allocating spectrum. | |
| CATV | Entry on the basis of registration with OPTA. | Before January 1998, CATV licences were limited one per geographical area. |
| Broadcasting | Subject to an individual licensing system (*i.e.*, a "beauty contest") according to the Media Act. | |
| **Line-of-business restrictions** | No line-of- business restrictions but firms must maintain separate accounts for telecommunications business. KPN was forced to reduce its CATV holdings, leading to an interest of only 20% in 1997. | KPN completely sold its holdings on Casema to France Telecom in 1998. |
| **Price controls** | | |
| On incumbent | Rate-of-return regulation (12.5%) implemented for fixed voice telephony and leased line services. Uniform tariff (geographically averaged rates) regulation implemented. | Price-cap lifted in July 1997, cost oriented tariffs introduced. It is planned to re-introduce price cap regulation in 1999 after establishing a reasonable starting point by using rate of return regulation. |
| On mobile operators | None. | |
| **Interconnection controls** | | |
| Prices | Prices based on a modified forward looking EDC (Embedded Direct Cost) accounting system. No requirement to make an "access deficit contribution" to the incumbent. | |
| Dispute resolution | Parties can notify a dispute to OPTA which must make a decision within 6 months. | Previously within a maximum of 5 months. |
| Scope | Interconnection for call termination is guaranteed. Unbundling of individual network elements may be required. | |
| **Spectrum allocation** | | |
| Mobile and WLL | Mix of "first-come-first-served" basis, and auctions; KPN and Libertel did not have to pay for GSM spectrum while new DCS1800 licensees do. | No licence required for DECT (Digital European Cordless Telecommunications) Technology. |
| Broadcasting | On the basis of a decision by the Ministry. | |
| **Numbering policy** | Local number portability and portability of mobile numbers planned for 1 January 1999. Carrier pre-selection planned for 1 January 2000. | Call-by-call carrier selection already exists. Portability of freephone numbers and premium rate/ shared cost numbers already exists. |
| **Universal service** | KPN is obliged to offer universal service without compensation for at least 12 months after it informs the Minister that it intends to end its USO provision. If, upon KPN's withdrawal, market forces prove unable to provide universal service, the Minister organises a tender, whereby the provision of universal service will be awarded to the operator which has tendered the lowest price. KPN has an obligation to participate in this tender. The cost of providing universal services will be shared by all telecommunications companies. | |

*Source:* OECD.

Even before liberalisation, KPN was regarded as one the most efficient carriers in the world. Its productivity and tariff structure are comparable to world best practices. Moreover, it achieved a 100 per cent digital switching system by 1994, earlier than any other operator in the OECD area.

Besides KPN there are currently 2 companies, EnerTel and Telfort, which provide full range nation-wide fixed voice telephony services. In addition, there are 125 CATV companies, a few of whom are already providing fixed voice telephony services at the regional level. The largest of the CATV companies are Casema, Castel, Edon and A2000. Casema is owned by France Telecom.

In mobile, KPN is the sole provider of analogue service. There are two GSM service providers, KPN and Libertel. KPN's market share in the GSM mobile market is 63.5 per cent. As mentioned earlier two further national licences for DCS1800 mobile service were offered earlier this year, to Federa and Telfort. At the same time sixteen smaller DCS packages varying from 2.4 MHz to 4.4 MHz were auctioned. KPN has obtained 7 of these smaller packages, Libertel 2, TeleDanmark 4, Orange/Veba 2 and Telfort 1. These frequencies can be used for a wide range of purposes, such as Wireless Local Loop and regional telephony, but can also be combined to constitute a nation-wide mobile telecommunications network. In fact, TeleDanmark is planning to build a nation-wide mobile network using frequencies which it acquired in co-operation with Orange. If TeleDanmark succeeds in developing a nation-wide mobile network, the Netherlands will have five national mobile companies.

Use of Internet in the Netherlands has grown rapidly over the last few years. It is estimated that about 1 million people in the Netherlands were users of the Internet in 1996. The Internet backbone in the Netherlands are NLnet and SURFnet, and Internet connections are supplied by 75 Internet providers. In addition to KPN which provides Internet services (World access) as well as intranet services and a national version of Internet (Het net), many CATV companies are also providing Internet service

## 2. REGULATORY STRUCTURES AND THEIR REFORM

### 2.1. Regulatory institutions and processes

From 1 January 1998, European Union telecommunications legislation requires the establishment of national regulatory authorities (NRAs) in the member states of the Union. The regulatory body must be legally distinct and functionally independent from all telecommunications organisations. A new independent regulatory body called OPTA (*Onafhankelijke post en telecommunicatie autoriteit*) was therefore established in August 1997. The Ministry is now mainly responsible for policy matters while implementation of regulation is the responsibility of OPTA.

Under the Act, the Minister of Transport, Public Works & Water Management (the Minister) is responsible for:

– establishing the frequency plan;

– granting licences for the use of sets of frequencies;

– establishing a numbering plan; and

– ensuring universal service.

Within the Ministry, the Department of Post and Telecommunications (HDTP) is the division responsible for telecommunications. HDTP comprises two operational units (the Directorate of Information Infrastructure and the Directorate of Market Development & Incentives Policy) and the Radio Communications Agency (RDR), an operational agency of HDTP which is in charge of frequency management, equipment type approval and related enforcement tasks.

OPTA is an independent regulatory body governed by a Commission of three permanent members, supported by a director with a professional staff. At present OPTA has a staff of 75. This is expected to grow to over 100 by the end of this year. It has a separate budget[9] approved by the Minister. OPTA is in charge of the supervisory and market-oriented executive tasks, including:

– administration of registration;

– issuing of numbers;

– supervision of compliance with the regulations;

– identifying operators with significant market power; and

– resolving disputes between parties in the telecommunications sector.

Decisions of OPTA as well as the Minister can be brought before the District Court of Justice in Rotterdam. District Court rulings can be appealed to the Court of Appeal for Economic Affairs in the Hague.

Despite the legal separation, the responsibilities of the Ministry and OPTA are closely related to each other as indicated in Table 3.[10] In addition, the Ministry still has regulatory power in the areas of establishing a numbering plan, assignment of universal service and giving exemptions from interconnection obligations which are critical elements of regulating a competitive telecommunications market. Retaining these functions within the Ministry reduces transparency and enhances the possibility of conflict between the different roles of the government as a regulator and a share holder. There is scope for further delegation of responsibilities to OPTA. In particular, the granting of spectrum licences should be carried out in as transparent and independent a manner as possible. Although responsibility for establishing the overall frequency plan could be retained within the Ministry, responsibility for granting licences should be devolved to OPTA.

Table 3. **Comparison of the roles and functions of the Ministry and OPTA**

| Area | Ministry | OPTA |
|---|---|---|
| Registration for market entry | No responsibility. | Responsible for accepting or refusing registrations. |
| Frequency | Responsible for establishing a frequency plan and granting licenses for the use of sets of frequencies. | Advice on economic aspects in Minister's radio spectrum allocation decisions. |
| Numbering | Responsible for establishing a number plan. | Responsible for assigning and reserving numbers. |
| Interconnection | In case of cross-border interconnection, able to give exemption from the interconnection obligation in light of a "distortion of competition". | Able to give exemption from the interconnection obligation in light of technical or commercial feasibility, able to lay down the interconnection rules when there is no agreement between parties, able to require changes in concluded agreements if they are in conflict with the law and designates network/service providers with significant market power (upon which an interconnection obligation can be imposed). |
| Leased line and Telephone service | No responsibility. | Responsible for designating providers of leased lines, public fixed and mobile telephone network/ service providers with significant market power (upon which obligations can be imposed). |
| Universal service | Able to assign universal service responsibilities to the significant market power service providers if universal service is not guaranteed by the normal functioning of the market. | Responsible for deciding the amount of compensation when it is needed. |

*Source:* OECD.

While content is still regulated by the Ministry of Education, Culture & Science and the Media Commission, OPTA has been given certain responsibilities in the broadcasting sector. In particular, OPTA has the authority to decide on disputes between CATV companies and program providers. Considering the trend toward convergence between telecommunications and broadcasting, it is opportune for the Netherlands to have a regulatory body which supervises both telecommunications and CATV.

To ensure that sector specific regulation is lifted when effective competition develops, the issue of whether OPTA's continued existence is necessary will be re-examined in 2002 by Parliament on the basis of the Minister's advice. The Minister will evaluate the effectiveness and efficiency of OPTA and

will report the conclusions of this evaluation to the Cabinet and Parliament. Parliament will decide eventually when sector specific regulation will be lifted.

On 1 January 1998, a general competition authority, the *Nederlandse Mededingingsautoriteit* (NMa),[11] was established in the Netherlands by the new Competition Act. The NMa is a semi-independent regulatory body; it acts on its own authority, but the Minister of Economic Affairs has the legal power to instruct it about particular cases. The NMa has been granted authority over the implementation and the enforcement of competition rules in all sectors of the Dutch economy by the Dutch Competition Act. While the Competition Act will in principle apply to the telecommunication sector, actions taken pursuant to OPTA's authority will be exempt. This issue is discussed further below in Section 2.2.8.

The role of the Ministry of Economic Affairs should also be mentioned. Although it is not a regulatory body, it plays an important policy role in areas such as electronic commerce and macro-economic related issues and is responsible for the implementation of the "National Action Program for Electronic Superhighways".

## 2.2. Regulations and related policy instruments in the telecommunications sector

### *2.2.1. Regulation of entry and service provision*

Since 1 July 1997, there have been no restrictions on market entry for network-based telecommunication activities in the Netherlands. This is consistent with both the EU Directives and the WTO's February 1997 Agreement on basic telecommunication services.

Under the Act, market entry is based on a process of general registration. Individual licences are only required for the use of frequency spectrum. Companies wanting to install or provide a public telecommunications network, leased lines or a broadcasting network, or to provide a public telecommunications service or a conditional access system need only register with OPTA.

In the case of mobile networks and services, the authority to grant a licence rests with the Minister. The granting of such licences takes place in the order of receipt of applications. However, the Minister has the right to decide to award the licences by way of a competitive test or an auction. Licences can be granted with restrictions attached. The Minister also reserves the right to revoke a licence under certain conditions.[12]

There is no specific regulation on Internet and video on demand (VOD) services. Both services are regarded as a telecommunications service. Internet telephony service is, in line with a communication of the European Commission, not regarded as public voice telephony. Therefore there are no additional rules applicable other than those for public telecommunication services in general (*e.g.* registration).

In the broadcasting sector, regulatory distinctions are drawn between broadcasting networks and broadcasting services. While the installation of a broadcasting network is regulated by the Act, broadcasting services are regulated by the Media Act (see Section 2.3).

Previously, CATV licences were issued on the basis of regional monopolies (*i.e.*, only one licence was issued in each region). However, OPTA decided to permit unlimited entry into the CATV market in January 1988 (multiple licences for the same geographical area is possible). This was done both to enhance competition in the CATV market (which was a regional monopoly) and to increase infrastructure competition in the telecommunications market.

The Act confers the general right to install and maintain cables for telecommunications or broadcasting networks over public land. Telecommunications companies only need to notify the relevant municipality before commencing their work.[13] Except for closed gardens and grounds forming part of occupied residential premises, telecommunications companies have rights of way on private land, where compensation is provided. In some cases, there may be cost savings to telecommunications companies if they are able to share ducts. While collocation and facility sharing is not required by the EU, the Netherlands, however, ensures sharing of cable ducts between telecommunications companies. The Act imposes an obligation on the telecommunications and broadcasting network providers to comply

with reasonable requests for joint use of provisions for laying cables when they are technically possible. Since the Netherlands ensures rights-of-way for all telecommunications companies and requires facility sharing by network operators, new entrants are able to enter the market in a short time with relatively low cost. As a result, rights-of-way and facility sharing requirements enhances the intensity of competition in the Dutch telecommunications market.

There are no restrictions on foreign ownership in the Netherlands and no limit on the share holding a single party (including a foreign company) can have in a telecommunications company. However, privatisation has not been emphasised as an integral part of market liberalisation. The government remains the largest single shareholder of KPN and owns the National Railway company that is a shareholder of Telfort. Experience in other countries has shown that occasions can arise where there is a conflict between policies which the government wishes to pursue as a shareholder and as a policy maker and regulator.

There are no line-of-business restrictions in the Netherlands, although companies offering both telecommunications and broadcasting services must maintain separate accounts for each activity. Similarly, although there are no restrictions on the provision of both fixed and mobile telecommunications services, KPN is required to maintain "accounting separation" between the PSTN and its mobile telecommunication services in order to prevent anti-competitive cross-subsidisation.

However, in two exceptional cases, line-of-business restrictions were imposed in order to foster new network investment and to prevent the leveraging of market power into newly developing product markets. The first case relates to the decision to require KPN to divest its interests in the CATV market. In 1997 KPN was asked to reduce its share holding of Casema to 20 per cent to ensure it would not control both telecommunications and CATV infrastructures. As a result, KPN sold all of its cable holdings to France Telecom. The other case relates to the DCS 1 800 auction process in which KPN and Libertel were simply prohibited from bidding for DCS 1 800 licences in order to enhance competition in mobile markets. In general, where there are concerns about market power, these concerns should be dealt with through reliance on national competition law.

In summary, the Dutch telecommunications marketplace is largely without restrictions with respect to entry, ownership or line-of-business. The absence of such restrictions is a significant strength of the regulatory regime. In addition, strong rights-of-way and requirements on facility sharing provide incentives to the new entrants to enter the market. However, the continued ownership of the state in KPN can give rise to a conflict of interest between the government in its role as regulator and in its role as owner. Consideration should, therefore, be given, to further privatisation of KPN.

### *2.2.2. Regulation of interconnection*

The EU Interconnection Directive came into force in August 1997 with a deadline of 31 December 1997 for implementation by Member states. The Directive prescribes the obligation for fixed network operators with significant market power to provide cost-oriented interconnection. The Directive also sets out the supervisory role of national regulatory authorities (NRAs) in ensuring publication of a "reference interconnection offer" describing the terms and conditions for interconnection. According to the Interconnection Directive, "an organisation shall be presumed to have significant market power when it has a share of more than 25 per cent of a particular telecommunications market in the geographical area in a Member State within which it is authorised to operate. NRAs may nevertheless determine that an organisation with a market share of less than 25 per cent in the relevant market has significant market power. They may also determine that an organisation with a market share more than 25 per cent in the relevant market does not have significant market power."

By the so called "July legislation", the Netherlands has imposed an obligation on KPN to interconnect and to give special access to any party wanting to use its fixed public telephone network for the provision of public telecommunications services. The interconnection requirements in the Act go further than the EU's Directive by including mobile service providers within the boundaries of interconnection obligations. According to the Act, if public telecommunication service providers receive a request for interconnection from other service providers, they must negotiate with each other in order

to conclude agreements. If no agreement is concluded, OPTA may stipulate a period within which an agreement must be concluded. Unless the providers are able to reach an agreement within the period, at the request of one or more of them, OPTA may lay down the rules which will apply. The Act requires OPTA to render a decision within six months of the request. In urgent cases, OPTA will make a provisional decision which will apply until the final decision is announced. If parties are not satisfied with the decision made by OPTA, they can appeal to the court.

Under the Act, besides general obligations, special obligations are imposed on interconnection providers with significant market power.[14] Such providers with significant market power (as designated by OPTA) have to offer non-discriminatory interconnection to other providers. The objective is to ensure that the interconnection terms which apply to other parties are the same as those which are applied to their subsidiaries. When there is a request from any telecommunications service provider, the designated interconnection provider has to supply all necessary information, including intended amendments to the network that are to be introduced in the next six months. The Act requires a designated interconnection provider to set up a cost accounting system[15] for interconnection in order to ensure transparent, cost-oriented, and sufficiently unbundled tariffs.[16] The burden of proof that interconnection charges are derived from actual costs lies with the companies providing interconnection to their facilities. Furthermore, the designated dominant interconnection providers are required to keep separate accounts of their activities relating to interconnection as opposed to other activities.

In regard to "cross-border interconnection", the Act requires that foreign telecommunications companies are treated in the same way as local companies. All foreign companies can request interconnection to local telecommunication companies in order to transmit calls originating from their countries to the Netherlands. However, if the compliance of "cross-border interconnection" results in a "distortion of competition",[17] the Minister can exempt companies from providing interconnection. The exemption of interconnection obligation is an *ex post* measure whereby the requested party should prove that the market is distorted because of actions of a foreign operator. Since the burden of proof lies on the requested parties, it is not likely that foreign operators would face difficulties to access to local companies' networks in order to terminate their calls. In addition, general competition rules are applicable when the Minister decides whether actions of a foreign operator cause a "distortion of competition".

In addition to interconnection, the Act contains provisions relating to "special access". Special access is access to a telecommunications network at points other than the network termination points that are offered to the majority of users. While interconnection obligations are imposed on all telecommunications network providers, special access is only required of companies with significant market power, on the basis of the request for access being reasonable. While special access is not mandated as strongly as interconnection, the "Interconnection Guidelines" have been interpreted as requiring operators with significant market power to offer full access at every feasible point in the public network. In addition, OPTA has ruled that the incumbent should offer unbundled subscriber lines to its competitors on the same terms as for its own use for xDSL (Digital Subscriber Line).

Forcing a firm to make its facilities available to a competitor at regulated prices is a relatively significant regulatory intervention whose scope should be strictly limited. Such intervention poses serious dangers of distorting incentives on the part of facilities owners for further investment in upgrading or R&D. Special access should only be granted to facilities which are clearly "essential facilities". In contrast, it appears that the intention in the Netherlands is to make special access available on a significantly wider basis.

In April 1998, OPTA ordered KPN to remove access deficit charges in its interconnection tariffs. This decision[18] was based on the view that the cost deficit in the line rental charges of KPN should not be recovered from interconnection access charges paid by competitors.

At present interconnection charges are based on embedded direct costs (EDC), a modified forward-looking LRIC (Long Run Incremental Cost) system. In practice, as Table 4 shows, all interconnection charges currently fall within a region consistent with EU "best current practice".

Table 4. **Comparison of interconnection charges***
ECU's/100 per minute

| | Local | Regional | National (> 200 km) |
|---|---|---|---|
| Netherlands | 0.94 | 1.25 | 1.61 |
| UK | 0.64 | 0.91 | 1.74 |
| Sweden | 1.14 | 1.75 | 2.38 |
| France | 0.71 | 1.73 | 2.55 |
| Germany | 1.00 | 1.71-2.16 | 2.61 |
| EU "Best current practice" | 0.60-1.00 | 0.90-1.80 | 1.50-2.60 |

* As of 11 March 1998. Interconnection charges per minute based on a 3 minute call duration.
*Source:* EU and OVUM.

Since the interconnection charges between KPN and Libertel have not been published until now, DG4 of the European Commission has asked OPTA to investigate this situation. DG4's action intends to prevent KPN from doing anti-competitive behaviour by taking advantage of its dominant market position. Since KPN operates both the fixed and mobile networks, interconnection between fixed and mobile takes place in-house. By contrast, for Libertel, the fixed network is a bottleneck facility, because most calls originating from mobile subscribers are completed to customers on the fixed network. Since KPN mostly provides in-house interconnection for its mobile service, interconnection charges are not an important issue from a company wide perspective. Not surprisingly, Libertel is inclined to seek low interconnection prices, while KPN seeks higher interconnection prices particularly since this would also weaken Libertel's competitive position.

In summary, the institutional regime governing interconnection in the Netherlands appears relatively sound. However, there is a concern over the interconnection charges in the mobile market due to the fact that the interconnection charges are not made public. Since there will be new DCS 1 800 service providers in the mobile market, OPTA should consider designating KPN as a company with significant market power in the mobile market in order to ensure that the same interconnection terms are provided to all mobile companies.

In addition, the provisions related to special access are currently being interpreted broadly to require more unbundling than is strictly necessary. Facilities should only be unbundled when they are "essential facilities" as defined in the EU competition law. Consideration should be given, therefore, to scaling back these provisions.

### *2.2.3. Pricing policy*

In general, with certain exceptions, neither the prices of new entrants nor the prices of the incumbent in the Dutch telecommunications marketplace are regulated. However, KPN's tariffs for voice telephony and leased lines are required to be cost-oriented.[19] If the other competitors file complaints about KPN's tariffs, KPN is required to provide information on its embedded cost to OPTA. If OPTA decides that KPN tariffs are not cost-oriented,[20] it is required to re-tariff its services. In practice, this would mean raising its prices on certain services. However, in order to prevent cost oriented pricing leading to unacceptable price increases for specific user groups, KPN is required to provide "a low user scheme".[21]

KPN is required to charge a uniform tariff over the entire country and is not allowed to differentiate tariffs between various regions until OPTA decides there is sufficient competition in the relevant markets. By contrast, KPN's competitors can differentiate their tariffs on a region by region and customer by customer basis. As a result, KPN is likely to have difficulty competing on the basis of price in low-cost markets like Randstad (a zone covering the main cities with 6 million inhabitants).

It is widely understood that this uniform tariff requirement causes market distortions and gives a significant competitive advantage to the new entrants. However the Dutch Government appears to believe that it is premature to abandon such asymmetric regulations. OPTA holds the view that to abandon KPN's uniform tariff obligation in the current market situation would raise concerns about the possibility of market entry by

other parties. In addition, it is believed that allowing KPN to differentiate tariffs by region would be politically unpopular. One reason for imposing a uniform tariff obligation on KPN is to prevent price discrimination between regions. However, the development of alternative telecommunications services such as mobile telephony can resolve this problem. In the longer term, when consumers in rural areas have many possible and affordable choices for their telecommunications services not only using the PSTN, but from CATV networks and mobile networks, as competition develops, the uniform tariff regulation will need to be abolished in order to ensure cost-oriented pricing in the marketplace. Lifting this uniform tariff obligation on KPN will boost price competition in the markets and accordingly benefit customers.

Price cap regulation has, in the past, been applied to the overall price of KPN's telecommunications services. For the years 1994-1998 the prices of two baskets were regulated: an "overall basket" of KPN's services and the price of a "small-user" basket. The overall basket included a broad range of services such as voice telephony, telex, telegraph, and cell-phone calls. The small users basket focused on basic voice telephony and cell-phone services for individuals and small business users. The price of neither basket was allowed to rise faster than the rate of inflation. This was a relatively light cap compared with some other countries. For example, in the UK and Australia, the price cap requires prices to decrease at 7.5 per cent less than the rate of inflation. In the US, the price cap on some operators is now inflation –6.5 per cent.

These price caps were lifted when KPN was required to move to "cost-based" tariffs in July 1997. Since July 1997, OPTA has imposed rate of return regulation[22] on KPN. OPTA views the adoption of rate of return regulation as a temporary measure in order to bring prices closer to costs and establish a reasonable starting point to re-introduce price caps. In fact, in October 1998, based on rate-of-return regulation OPTA made a ruling which would eliminate KPN's discounts for corporate telephone service clients by 1 January 1999. Using rate of return methodology as a "one-off" tool OPTA is trying in 1998 to place pressure on KPN to adjust its prices much closer to costs, after which, in 1999 price caps will be used as the price control mechanism. In effect, OPTA is trying to achieve over the last year quite rapid rate re-balancing. Although it is clearly difficult to obtain cost information this "one-off" approach avoids a long process of upward "ratcheting" which occurred in the UK with the price caps on BT. However, it is important to allow longer term planning stability for KPN which would come from price caps and for this reason they should be introduced as soon as practicable. Since it is generally understood that rate-of-return regulation generates undesirable incentives for inefficient behaviour, such as over-investment and various cost-padding activities. Moreover, profit controls are hardly likely to stimulate the risk-taking investments which will be required to materialise the promise of convergence.

Mobile services are not subject to price regulation.

In summary, the uniform tariff requirement on KPN hinders the ability of KPN to compete and places a protective umbrella over competitors. In order to ensure cost oriented pricing, the uniform tariff requirement on KPN should be lifted as soon as consumers in rural area have enough affordable choices for telecommunications services in any of its forms. Furthermore, in the current regulatory framework, price regulation or general competition principle is sufficient to control anti-competitive predatory pricing when it exists. Where competitors have concerns about the pricing practices of KPN (or other telecommunications firms) they can complain to OPTA (or the NMa). In addition, the re-introduction of price caps should not be delayed.

### *2.2.4. Service quality*

The EU ONP Directive (95/62/EC) requires member state NRAs to establish and publish targets for time to supply initial network connections, fault rates per connection, fault repair times, call failure rates, dial tone delay, transmission quality statistics, response time for operator services, the proportion of coin and card-operated public pay-telephones in working order, and billing accuracy as service indicators. To meet EU ONP requirements, the Act requires OPTA to set targets to meet certain quality levels in specific services.

At present, the Netherlands has a general quality of service condition imposed on KPN for its fixed network and services. In addition, it has an independent body – *the Stichting Geschillencommissie Consumentenzaken and Geschillencommissie Telecommunicatie en Post* – which deals with consumer complaints. Whenever a consumer and KPN cannot reach an agreement, the customer has the option of appealing to this independent body. There were 44 complaints in 1995 and 49 complaints in 1996. A summary of complaints and an indication of decisions made is published in the KPN's annual report and in the report of the independent body. Another mechanism for consumer protection is the representation of the National Consumer Organisation on the OPT, a body where the government, all industry players, consumer and user organisations, and employer/industry interest organisations are brought together.

### *2.2.5. Resource issues*

*Spectrum allocation*

To obtain spectrum in the Netherlands, it is necessary to obtain a licence from the Minister. A licence may be granted subject to restrictions, especially where there is a scarcity of frequency. Certain uses of spectrum have priority in obtaining licences, namely spectrum necessary for the performance of essential government tasks, for carrying out tasks in the area of public broadcasting, and for the implementation of a statutory rule. Except for these cases, frequency is granted on a "first come first served basis" by a competitive test, or an auction. In the Netherlands, while both methods can be used under the Act, the Ministry seems to prefer auctions.[23] Recently the Dutch Government used an auction to allocate the two national DCS/GSM-licences and 16 smaller packages of DCS 1 800 frequencies for mobile communication.[24] According to the Minister, frequency for commercial radio broadcasting will be auctioned in 1999/2000.

Since new DCS 1 800 licensees paid very high spectrum licence fees, there is a concern that such high licence fees impose a substantial tax on end-users. If the new DCS 1 800 licence holders pass on the cost incurred to acquire spectrum to users, the impact of new entrants in the mobile market will be hampered. There is also an issue of competitive neutrality as KPN and Libertel (and other broadcasting companies) obtained spectrum for free, while new entrants face high spectrum licence fees. The Dutch Government tried to address this issue by retroactively attempting to collect from Libertel and KPN an amount corresponding to the amount that the DCS 1 800 licensees paid. But Libertel complained to the EU's competition authority which held that requiring retroactive payments is illegal. As a result, the Dutch Government changed its position to collect licence fees from Libertel and KPN.

According to the Act, while mobile licences, which includes rights to use spectrum, are not transferable unless the Minister gives an exemption, the Act stipulates the cases such as a violation of the frequency plan which are not granted an exemption from the Minister. Therefore, except for those cases which are stipulated in the Act, in principle the transfer of a licence is allowed in the Netherlands.

In summary, while the change of in the method for spectrum allocation from a competitive test to an auction might have increased the efficiency of spectrum allocation, it raised problems of competitive neutrality between the previous licence holders and the new entrants. In this regard, the Dutch Government needs to ensure that new entrants are not at a disadvantage to compete with previous licence holders in the mobile market. To designate KPN as having significant market power in the mobile market can be one solution, because it will ensure transparent and non-discriminatory interconnection between market players.

*Numbering issues*

The accelerated development and modernisation of telecommunication infrastructure competition and the increasing number of new facility-based carriers has highlighted the importance of telecommunication numbering policy.[25] In particular it is now recognised that, "portability" of telephone numbers is an essential feature of a competitive market in telephone service. In a competitive marketplace, telephone subscribers must be permitted to change telephone service providers without changing numbers, *i.e.*, without taking on a new network identity. New entrants will have considerable difficulty in

attracting customers from incumbents if customers are required to change their numbers. Considering the importance of number portability, the European Commission has proposed that when markets open to facilities and voice competition in 1998, users should be able to select service providers on a call-by-call basis, and by 2003 number portability should be available in major urban areas.

In 1995 the Dutch Government carried out a preliminary study on number portability. Based on the results of the study, the Ministry set out a schedule for local number portability.[26] It was decided that local number portability shall be implemented by 1 January 1999 for both the fixed and mobile networks. Notably, the inclusion of mobile services exceeds the EU requirement regarding number portability.

The Act prescribes that the service for which the provision of number portability will be determined by a governmental decree. Designated providers are obliged to offer number portability to customers changing service provider, changing address within a certain area, and purchasing a different telecommunications service from the original service provider. Because of the high cost of implementing number portability, the Act provides for the government to make rules with respect to how such costs may be passed on. In fact, the Act articulates numbering policy issues in some detail. While the Minister is responsible for establishing a numbering plan, OPTA is responsible for assigning numbers and also for keeping a register of numbers.

Another important numbering issue is equal access to customers. The European Commission proposed that the carrier pre-selection[27] systems be introduced by 1 January 2000 in order to maximise consumer choice and reduce prices. The European Commission calculates that the benefits of introducing carrier pre-selection could amount to as much as ECU 20-25 billion in Europe per year. While there is an argument that introducing carrier pre-selection may undermine investment in local infrastructure by reducing and redirecting profits to long-distance services otherwise flowing to local access operators, this argument will be of less importance in a world of fully re-balanced tariffs in which local charges and long-distance charges fully cover the costs of local and long-distance service, respectively.

Since 1 July 1997, the Netherlands has had a dialling system that allows carrier selection on a call-by-call basis. The subscribers can choose an alternative carrier for their international and national phone calls by dialling a four digit carrier selection code. This alternative carrier does not necessary need to have its own infrastructure. In the Netherlands, carrier pre-selection is regarded as a form of special access in which terms and conditions are negotiated by the interested parties. In the Netherlands, KPN is preparing its network for carrier pre-selection to be in place by 1 January 2000. KPN has also started negotiations with market parties concerning the terms and conditions of access. In line with these activities, OPTA has begun a market consultation about special access and carrier pre-selection to be able to settle disputes on carrier pre-selection quickly as they arise.

To ensure equal access in the transition to a competitive market, OPTA examined the usage of numbers by the incumbent operator in order to ascertain that this number-usage would not hamper access to numbering resources for new market entrants. In this context, KPN's rights to use "special numbering resources" (*e.g.* four-digit VPN access code) were withdrawn. OPTA also decided to allocate the commercially valuable free-phone numbers and premium rate/shared cost numbers directly to the end using companies, by means of OPTA's own call centre.

In summary, the Dutch government has moved very fast to implement number portability and carrier pre-selection in the telecommunications market. As a result, it can be expected that new entrants will enjoy equal access to end customers. In particular, the inclusion of mobile services in number portability is a very appropriate decision considering the rapid growth of mobile service market.

### *2.2.6. Universal service obligation*

The Netherlands has taken a step by step approach to universal service based on a market solution.[28] KPN is obliged to offer everyone certain basic public telecommunications services or facilities of a certain quality at an affordable price without financial compensation until 12 months after it informs

the Minister that it intends to end the USO provision. If, upon KPN's withdrawal, market forces prove unable to provide universal service, the government will intervene in the market. The Minister will organise a tender, whereby the provision of universal service will be awarded to the operator which tendered the lowest price. KPN has an obligation to participate in this tender. The cost[29] of providing universal services will be shared by all telecommunication companies.[30]

Box 2. **Universal service coverage in the Netherlands**

- Access to and use of the fixed voice telephone network.*
- Availability of a sufficient number of public telephone boxes (1 per 5 000 inhabitants).
- Free access to emergency service.
- Availability of telephone guidebooks and public telephone information service.

* More specifically, a low user scheme which guarantees affordable connection to and use of the fixed voice telephone network for users who have very limited call volumes.

While the Netherlands has specified a mechanism to ensure universal service, it takes the position that the development of effective competition will reduce the unprofitable regions and customers, and that eventually market forces can provide universal service to all customers.

In view of the strong possibility that significant competition will develop in the Netherlands, this "wait and see" approach to universal service provision appears sound. Experience in other countries shows that competition tends to enhance the penetration of telephone service. This has occurred, for instance, through the entry of niche market operators (*e.g.*, providing pay-phones as in the UK) into areas once considered to be loss making.

### *2.2.7. International aspects*

The Netherlands as a member country of the EU, made commitments in the context of the WTO Agreement on basic telecommunications service which was signed on 15 February 1997 and came into effect on 5 February, 1998. The Netherlands committed to the WTO schedule of the EU with no exceptions or conditions. Access to the Dutch market is totally open to foreign service providers including call-back service providers. Service providers do not need a legally registered representative in the Netherlands to provide a service in the country. There are no restrictions regarding the size of share

Table 5. **The Netherlands WTO commitment as a Member country**[1]

| Range of services[2] opened | Timing of liberalisation | Commitment to common set of regulatory principles | Foreign ownership restrictions | MFN exemptions |
|---|---|---|---|---|
| Full | By 1 January 1998 | Full | No | No |

1. The EU offer commits to complete liberalisation of basic telecommunication services (facilities-based and resale) across the EU for all market segments (local, long distance and international). The offer also covers, for instance, satellite networks and services and all mobile and personal communications services and systems. Restrictions include foreign equity limits by France (20%: radio-based services, direct investment only) and Portugal (25%). Full liberalisation of public voice telephony and facilities-based services is to be implemented on a delayed basis only by Spain in December 1998; by Ireland in 2000; by Greece in 2003; and by Portugal in 2000 for public voice telephony and July 1999 for facilities based services. Liberalisation of internationally connected mobile and personal communications services is to be implemented on a delayed basis only by Ireland and Portugal in 1999.
2. In the EU commitment on WTO basic telecommunications services agreement, telecommunications services are defined as the transport of electromagnetic signals-sound, data image and any combinations thereof, excluding broadcasting.

*Source:* WTO.

holding or other ownership restrictions on individuals and corporations investing in telecommunications service providers.

As a result of the market opening measures, foreign telecommunications companies are able to establish new network infrastructure inside the Netherlands and become a facilities-based carrier providing cross-border services or resale carrier services. In addition, foreign telecommunications companies enjoy the same interconnection rights as local telecommunications companies, except in cases where there is a "distortion of market" (see Section 2.2.2).

### *2.2.8. Streamlining regulation and application of competition principles*

Under the Act, OPTA is responsible for telecommunications issues such as number allocation, the interconnection accounting system, and the designation of companies with significant market power. The regulation of competition law issues such as anti-competitive agreements, anti-competitive mergers and abuse of dominance are assigned to the NMa. While, there is potential for conflict between the OPTA's regulatory responsibilities and those of the NMa because of the exemption under Article 16 of the Competition Act (see background report on The Role of Competition Policy in Regulatory Reform) for conduct which is or could be regulated by a regulatory agency such as OPTA,[31] there is as yet no example of OPTA issuing an order in an area under the authority of NMa

In terms of the interpretation of competition rules, while OPTA and the NMa need to reach an agreement on general guidelines in relation to competition, OPTA can make its own decisions regarding anti-competitive conduct which is regulated by the Act. Since the EU's Treaty of Rome is a common guideline for both the NMa and OPTA, it reduces the risk that competition-related decisions taken by OPTA in the context of the telecommunications industry may not be consistent with decisions concerning the wider economy taken by the NMa.

In order to ensure consistent regulation across industries, OPTA and the NMa are now trying to develop close co-operative relationship. Both agencies recognise that this co-operation is vital not only for the success of both new organisations but for the whole Dutch economy. As part of this co-operative process, OPTA and the NMa are sharing information as well as carrying out joint policy-related research on important telecommunication issues such as cross-subsidisation and pricing. In addition, OPTA and the NMa are developing a protocol on co-operation for the development of competition principles in regulating the Dutch telecommunications market.

In addition, in certain cases the Act requires the Minister to consult with the NMa before making decisions as in the case of denial or revocation of a mobile licence because of "the considerable restriction of real competition on the relevant market". However, there is no mandate for the Minister to consult with the NMa when it decides to permit transfer of a mobile licence. The Minister should consult the NMa also in such cases in order to ensure consistent implementation of competition rules across the industry.

Although OPTA's performance and existence will be reviewed by Parliament in 2002, there are no requirements to undertake a regular assessment of the need to streamline regulation. While OPTA can waive application of regulations in areas such as the requirement for uniform tariffs, there are no explicit forbearance provisions. While sector specific regulation can assist in the transition phase from monopoly to competition as market forces become stronger, the sector specific regulation will need to be phased out.

## 2.3. The dynamic view: convergence in communications markets

Although the Netherlands is still in the process of establishing a new telecommunications regulatory framework, the rapid convergence taking place between broadcasting, content and communications technologies and services requires consideration of "next generation regulation". The Act removes most network-specific regulation by allowing networks to be used for any purposes. However service-specific regulation still exists in markets and the broadcasting market is still heavily regulated by many government agencies. A challenge for Dutch regulation is to move speedily from service-specific

regulation to regulation based on competition policy principles so as to ensure regulatory consistency between converging sectors.

Following the revision of the Media Act in 1997 and the implementation of the Act, there are no line-of-business restrictions between broadcasting services[32] and telecommunications services. But broadcasting services are still subject to an individual licensing system.[33] The Act requires accounting separation between telecommunication and non-telecommunication activities in order to prevent cross-subsidisation. In the market place some innovative initiatives are coming from CATV companies with most big CATV companies now offering Internet services to customers.[34] For example, A2000 is offering voice telephony services using its cable network.

It is possible that differences in regulatory treatment of the different sectors are already distorting investment. One example is, differences in the regulatory treatment of Internet telephony and other forms of telephony. It is likely that for KPN, the stricter regulatory requirements it faces in the market for conventional PSTN services make the Internet an attractive alternative. KPN plans to invest US$317.2 million over two and half years to boost its Internet business, investing in more Internet technology, dial-in structure and software to order to increase its NET users up to two million (a quarter of its 8 million telephone users) by the end of 1998.

Communications convergence in the Dutch communications market is bringing the fragmented regulatory structure between telecommunications and broadcasting into sharp focus. Currently, the telecommunications market is regulated by the Act while the broadcasting market is regulated by both the Act and the Media Act. While all networks are regulated by the Act, broadcasting and telecommunications *services* are regulated by different laws. However, with the convergence of two communications media, it is becoming increasingly difficult to designate individual operators and even services as falling into one category or another. Such fragmented regulation not only restricts companies from taking full advantage of technology innovation and business opportunities, but also prevents users from enjoying better possible services. In this regard, a review of current institutional structures and procedures may be a primary requirement for the Netherlands in order to assess whether existing structures are suitable to a converging communications environment. At minimum there is a requirement at an early stage to ensure much closer co-operation and the determination of common policy goals between regulatory institutions in both sectors.

Table 6. **Comparison of the regulatory framework between telecommunication and broadcasting**

| | Telecommunication | Broadcasting |
|---|---|---|
| Regulatory regime | The Telecommunications Act | The Media Act,<br>The Telecommunications Act[1] |
| Market entry | No restriction (only registration is needed) except access to frequency (licence is needed) | – Network: same as telecommunications<br>– Service: individual licensing system[2] |
| Regulatory institutions | OPTA,<br>Ministry of Transport, Public Works & Water Management | – Technical issues: OPTA, Ministry of Transport, Public Works & Water Management<br>– Content related issues: Ministry of Education, Culture & Science, Media Commission, National Broadcasting Organisation |

1. It has a provision on broadcasting licences and obligations for broadcasters to carry prescribed types of television programs.
2. The public broadcasting and commercial broadcasting of television programs require individual licences. Since July 1995, there have been no restrictions on parties to obtain an individual licence to operate Satellite Earth Stations (SES).

*Source:* OECD.

## 3. PERFORMANCE OF THE TELECOMMUNICATIONS INDUSTRY

Having set out the key features of the regulatory regime, we now assess the level of competition in the marketplace and the performance of the regime.

### 3.1. Competition analysis

The market for traditional voice telephony can be divided into many sub-markets, corresponding to local, long-distance and international, rural and urban, residential and business.

Before 1994, KPN was the only telecommunications company providing voice telephony service for PSTN and mobile services. With entry barriers now abandoned, more than 100 companies are providing telecommunications networks and/or services. For PSTN services there are 3 companies providing nation-wide services and 5 CATV companies with interconnection agreements.

There are several reasons to be optimistic about the future of competition in the market for long-distance and international services. The market share of the new entrants reached 20 per cent at the end of 1997, six months after the introduction of competition. There are the large number of telecommunication infrastructure providers and barriers to entry into these markets are low. In addition, these markets face competition from resellers, from call-back operators and, most importantly, from Internet telephony. Indeed, facing up-coming competition from new licensees in PSTN services (especially in international service), KPN substantially reduced its international telephone rates on 3 October 1997, for calls over the fixed network. All international rates were cut by an average of 25 per cent, and a number of rates were reduced by 50 per cent or more. Furthermore, KPN significantly cut its international rates again on 1 July 1998. For instance, there were cuts of more than 50 per cent for calls to Australia and New Zealand. There is little remaining reason to be concerned about the level of competition in these markets.

In the business market, experience in other countries suggests that facilities-based entrants can compete effectively through targeting business customers as the spring board to broader market penetration. This pattern is being repeated in the Netherlands. Both EnerTel and Telfort compete well in the business market by offering services based on lower prices and new fibre optic cables. For example Telfort has contracts with many big business companies such as Unilever, Shell, and Philips. It is likely therefore, that in the near future under the current regulatory regime, businesses in the large cities will face real choice in their local telecommunications service provider.

As in all countries, local service competition presents more significant barriers to entry. In the Netherlands, the existence of a virtually ubiquitous CATV network presents an obvious alternative to the bottleneck of the local loop. CATV operators in other countries (most notably the UK) are already successfully offering voice telephony services. Indeed, in the Netherlands, A2000 has been offering voice telephony over its cable network in the Netherlands since 1997. Although at present only 5 cable companies have successfully concluded interconnection agreements, it is expected that this number will significantly increase. In addition, the local loop faces competition from mobile services. As discussed below, there is currently a high level of competition in the Dutch mobile market with a wireless local loop (WLL) emerging as a potentially viable alternative. In the light of these developments it may reasonably be expected that adequate competitive pressures will soon exist in the local rural and residential market, if they do not do so already.

In the mobile market, the granting of licences for DCS 1800 increases the number of mobile communication companies from two to four (or five if TeleDanmark succeeds in building a nation-wide mobile network). Thanks to the early start of its GSM service (just one year later than that of KPN's),[35] Libertel competes closely with KPN in the mobile market.[36] Libertel's major shareholders[37] are the Dutch financial giant ING Group and the English mobile service provider Vodafone, a combination which ensures that Libertel has both the financial and technical ability to compete with KPN.

Because there are no line-of-business restrictions in the Dutch telecommunication market, the major players are aiming to become full service providers offering both mobile and fixed voice telephony services. The two new national fixed voice telephony service providers in particular think it is essential to be a full service provider in order to compete with KPN which provides both fixed and mobile telephony services. Telfort achieved its goal by acquiring new DCS 1 800 license and EnerTel officially announced its intention to become a full service company. In the longer term, it is likely that companies will have just one bill for customers using the same company's fixed and mobile services. Moreover if competition increases sufficiently, companies can bundle fixed and mobile services, a practice already implemented in Denmark.

In many European countries, liberalisation of the domestic market has led to competition between a national incumbent and new companies with connections to foreign incumbents. The Netherlands is no exception. All new companies are related to large foreign companies such as BT, Vodafone and France Telecom. This implies that competition in the Netherlands is not a battle between a "Goliath" and many small "Davids" but a war between giants. This situation has led KPN to argue that asymmetric regulation does not help customers but assists foreign companies based in countries in which KPN does not yet compete. In addition, many foreign telecommunications operators like Global One, and Worldcom are present in Dutch telecommunication market without alliance with Dutch local firms. They offer X.25 services, Frame Relay services, IP/Internet access services, Virtual Private Network services, Value Added Network services, and Managed Bandwidth services. Some companies are planning to offer ATM services. Worldcom has offered its network services to business customers in Amsterdam since 1997.

Overall, the outlook for competition in the Dutch telecommunications marketplace is very good.

### 3.2. International performance comparisons

Because the Dutch telecommunications liberalisation is so recent (indeed, important elements of the regulatory regime have not yet been put in place) it is difficult, if not impossible, to assess at this stage the overall performance of the new regime.

Table 7. **Time series of the Netherlands and OECD average residential tariff basket***
US$PPP (excluding tax)

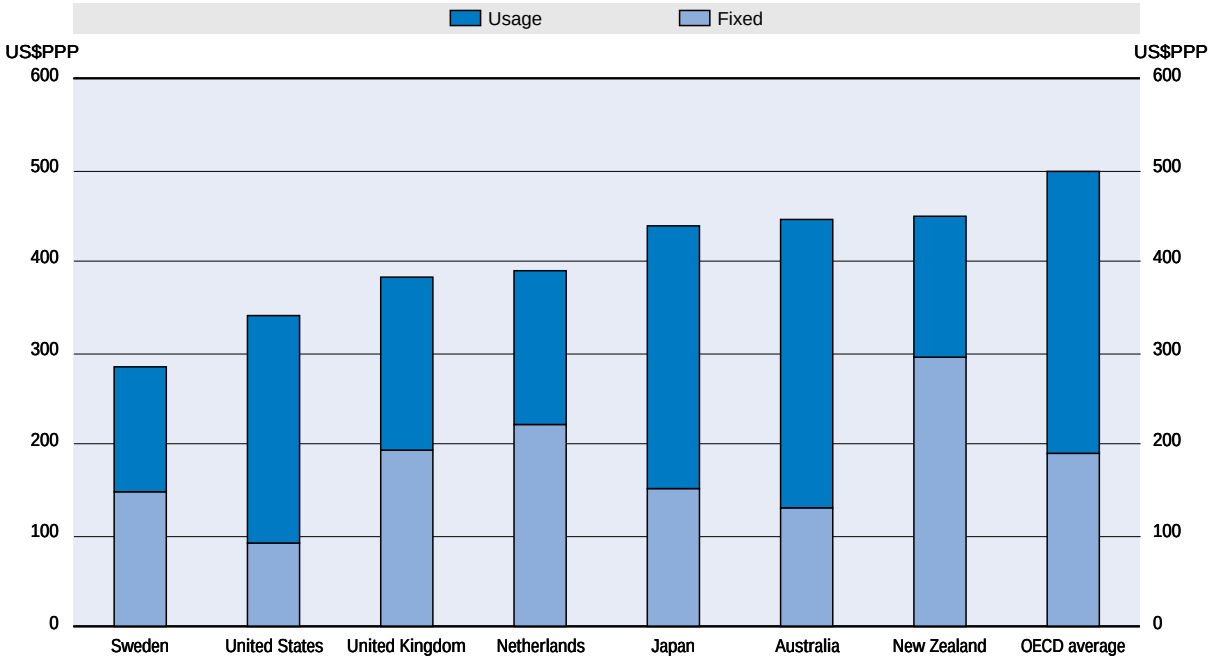
| | Netherlands | | | OECD average | | |
|---|---|---|---|---|---|---|
| | Fixed | Usage | Total | Fixed | Usage | Total |
| 1993 | 147.40 | 76.13 | 223.53 | 146.31 | 188.36 | 334.67 |
| 1994 | 156.22 | 81.76 | 237.98 | 146.40 | 183.07 | 329.47 |
| 1995 | 159.16 | 83.30 | 242.45 | 158.82 | 191.83 | 350.65 |
| 1996 | 174.93 | 89.14 | 264.07 | 163.39 | 175.36 | 338.75 |
| 1997 | 148.72 | 66.40 | 215.12 | 146.60 | 158.23 | 304.83 |
| 1998 | 153.19 | 104.82 | 258.01 | 149.88 | 153.17 | 303.05 |

* Residential Tariff Basket does not include international charges. The usage charges are deflated by number of calls. For these and other baskets, figures are for January of each year. For a full description of the tariff comparison methodology for these and other baskets, see OECD, ICCP Series No. 22, Performance Indicators for Public Telecommunications Operators.
*Source:* OECD and EURODATA.

Among the available indicators, price movement is probably the most sensitive to changes in the market. Moreover, in the customers' view, price change is arguably the most important factor in evaluating the success of liberalisation. Since July 1997 when the Dutch fixed voice telephony market was liberalised, competition has arisen mainly in the business market (leased lines) and in the international market. To face challenges from new competitors, KPN undertook a significant rebalancing in its tariff structure. Overall, as Table 7 and Figure 1 indicate, the Dutch residential basket is cheaper than the OECD average. However, average residential users have not been made better off in terms of prices since the liberalisation of the telecommunications market. Indeed, as Table 7 indicates there has been a significant rise in usage charges between 1997 and 1998, due to the introduction of call set-up charges in July 1997. The price of the Dutch residential basket may be deceptive because it does not reflect the introduction of per-second charges which would have reduced the actual price paid. In light of KPN's argument that the set-up charges are revenue neutral, the usage charges may be exaggerated due to not reflecting the per second charge scheme.

The Netherlands business tariff basket shows one of the better performances among OECD countries.[38] However the usage charge for business users appears to have increased significantly after the introduction of competition due to the set-up charge.

Figure 1. **Comparison of residential tariff basket (August 1998)**




*Source:* OECD and EURODATA.

Table 8. **Time series of the Netherlands and OECD business tariff basket***

US$PPP (excluding tax)

| | Netherlands | | | OECD average | | |
|---|---|---|---|---|---|---|
| | Fixed | Usage | Total | Fixed | Usage | Total |
| 1993 | 147.40 | 263.53 | 410.93 | 180.79 | 633.04 | 813.83 |
| 1994 | 156.22 | 285.79 | 442.01 | 181.46 | 613.65 | 795.11 |
| 1995 | 159.15 | 291.16 | 450.31 | 181.60 | 621.91 | 803.51 |
| 1996 | 148.88 | 265.45 | 414.33 | 178.76 | 559.63 | 738.39 |
| 1997 | 148.72 | 245.16 | 393.88 | 190.00 | 581.17 | 771.17 |
| 1998 | 153.19 | 359.92 | 513.11 | 199.44 | 566.70 | 766.14 |

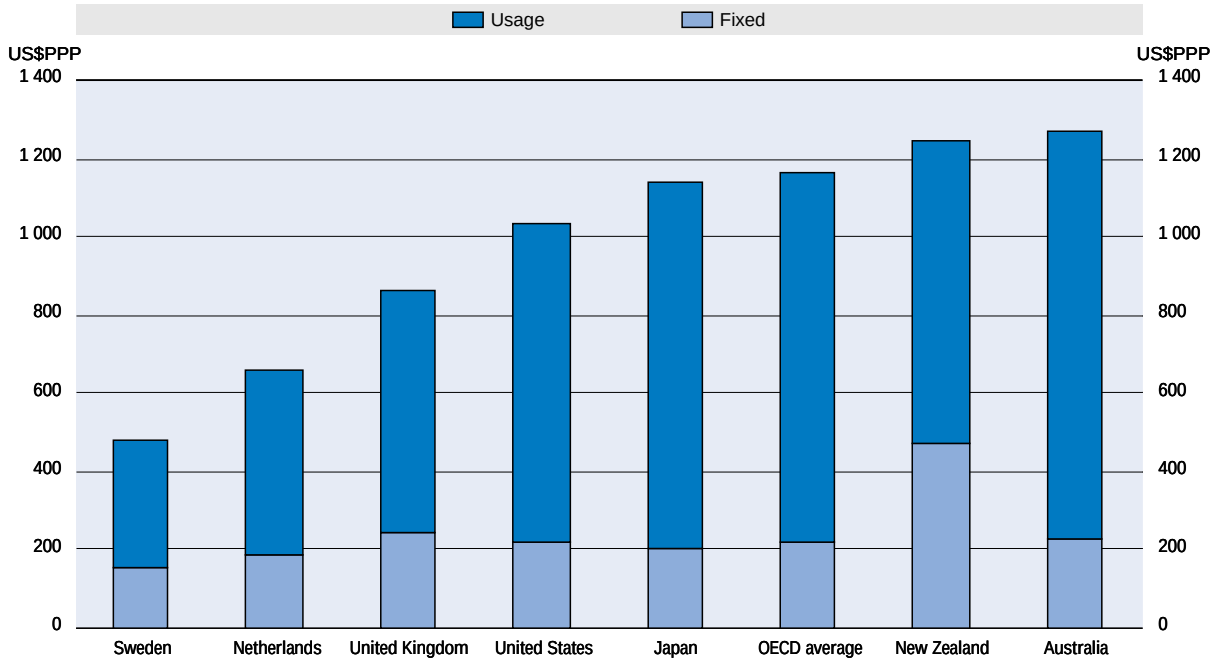
* Business Tariff Basket does not include international charge. Business Tariff Basket is mainly for small and medium size firms which do not use leased lines. The usage charges are deflated by number of calls.

*Source:* OECD and EURODATA.

While the residential and business tariff baskets show increases after introducing competition, international call charges have dropped significantly by much more than the average drop in OECD countries, mainly due to enhanced competition.

Because leased lines services were liberalised as early as 1993, leased lines services provide clearer evidence of the impact of liberalisation. In 1994, just after the introduction of competition, leased line charges were reduced significantly. Due to continuing strong competition in leased line services such as packet switched data transport services and simple resale of leased lines capacity in the Netherlands, the Netherlands has much lower prices for all capacities of leased lines than the OECD average. In 1997, companies with new infrastructure licences entered leased lines services using CATV networks and other alternate infrastructure (*e.g.* fibre optics for railway company and electricity companies). This was an

Figure 2. **Comparison of business tariff basket (August 1998)**




*Source:* OECD and EURODATA.

Table 9. **Time series of the Netherlands and OECD international usage tariffs**
US$PPP (excluding tax)

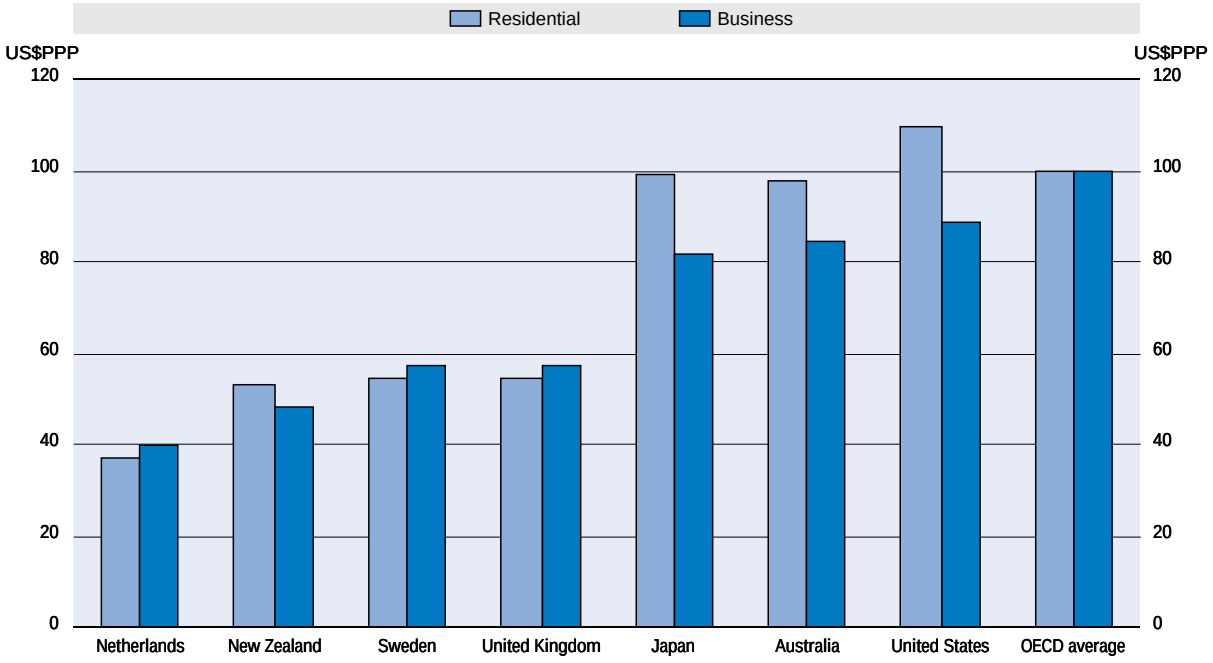
| | Netherlands | | OECD average | |
|---|---|---|---|---|
| | Peak 1 minute | Cheap 1 minute | Peak 1 minute | Cheap 1 minute |
| 1993 | 0.80 | 0.61 | 1.16 | 0.89 |
| 1994 | 0.80 | 0.62 | 1.06 | 0.79 |
| 1995 | 0.76 | 0.65 | 1.00 | 0.74 |
| 1996 | 0.60 | 0.48 | 0.86 | 0.65 |
| 1997 | 0.71 | 0.57 | 0.93 | 0.67 |
| 1998 | 0.36 | 0.32 | 0.80 | 0.63 |

*Note:* One minute charge is calculated by one (one initial + three additional minutes)/4.
*Source:* OECD and EURODATA.

important factor driving significant price cuts in 9.6 kbit leased lines (although another factor was the migration away from such low speed lines).

In October 1995, Libertel launched its mobile service and the subsequent competition made an immediate impact on mobile tariffs. In 1996, fixed mobile charges were reduced almost 30 per cent from the previous year. However, the duopoly situation between Libertel and KPN appeared to impede any further improvement in tariffs. In 1998, the Dutch mobile tariff basket was just below the OECD average.

Figure 3. **Comparison of international tariff basket (August 1998)**




*Source:* OECD and EURODATA.

Table 10. **Time series of the Netherlands and OECD leased lines tariff basket***

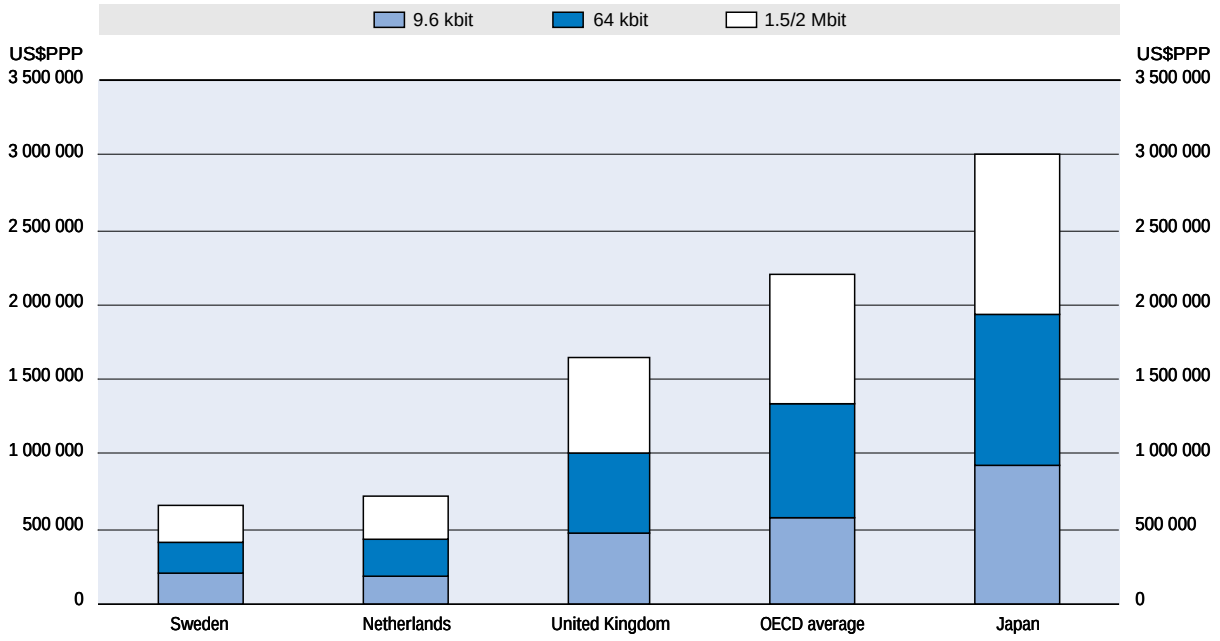
US$PPP (excluding tax)

| | Netherlands | | | OECD average | | |
|---|---|---|---|---|---|---|
| | 9.6 kbit | 54/64 kbit | 1.5/2 Mbit | 9.6 kbit | 54/64 kbit | 1.5/2 Mbit |
| 1993 | 57.386 | 107.078 | 512.557 | 45.954 | 102.107 | 633.399 |
| 1994 | 34.065 | 64.865 | 340.051 | 43.405 | 80.292 | 495.049 |
| 1995 | 38.251 | 64.258 | 369.624 | 44.714 | 70.657 | 432.232 |
| 1996 | 30.360 | 51.198 | 294.588 | 37.008 | 68.569 | 387.929 |
| 1997 | 18.681 | 44.885 | 256.908 | 34.756 | 60.388 | 356.241 |
| 1998 | 17.796 | 40.314 | 233.575 | 32.648 | 49.382 | 294.339 |

* Monthly rental charge. Due to missing data, the following countries are excluded from OECD average:
9.6 kbit: Portugal, Sweden, Mexico.
54/64 kbit: Australia, Iceland, Sweden, Turkey, Mexico.
1.5/2 Mbit Australia, Finland, Sweden, Switzerland, Mexico.

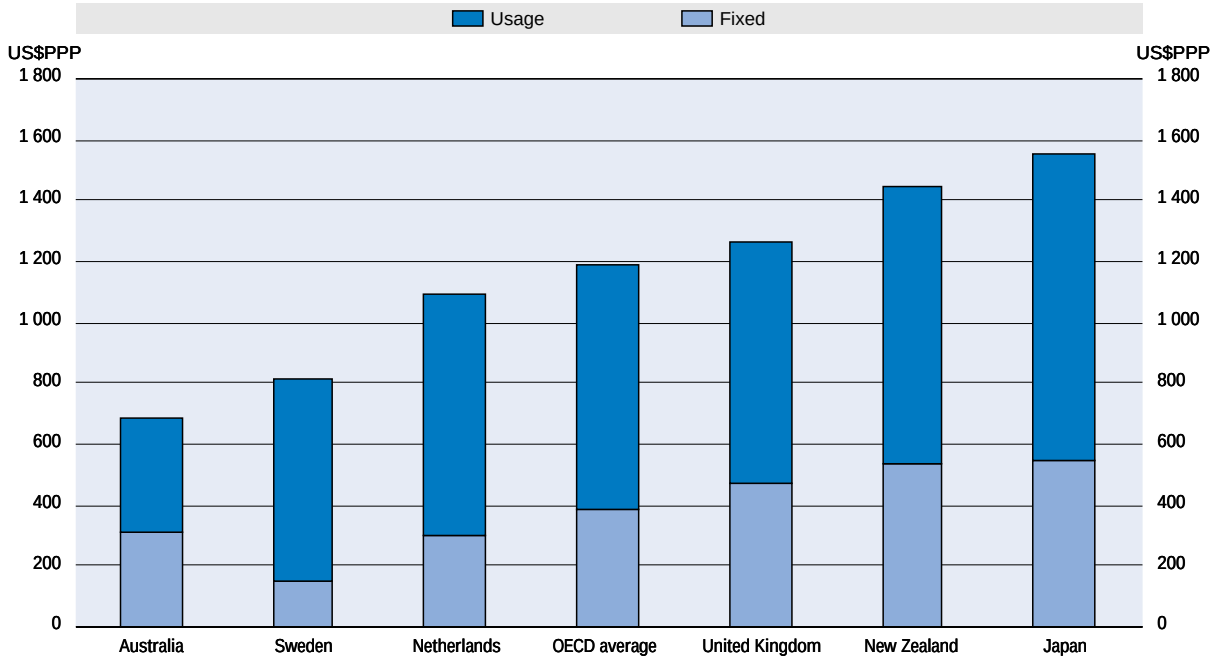
*Source:* OECD and EURODATA.

Figure 4. **Comparison of leased line tariff basket (August 1998)**




*Note:* Yearly rental charges.
*Source:* OECD and EURODATA.

Figure 5. **Comparison of mobile tariff basket (August 1998)**






*Source:* OECD and EURODATA.

Table 11. **Time series of the Netherlands and OECD mobile tariff basket***
US$PPP (excluding tax)

| | Netherlands | | | OECD average | | |
|---|---|---|---|---|---|---|
| | Fixed | Usage | Total | Fixed | Usage | Total |
| 1993 | 480.97 | 984.86 | 1 465.83 | 459.21 | 1 005.57 | 1 464.77 |
| 1994 | 402.46 | 969.56 | 1 372.02 | 410.38 | 956.95 | 1 367.33 |
| 1995 | 295.88 | 943.17 | 1 239.05 | 390.55 | 905.84 | 1 296.39 |
| 1996 | 295.58 | 1 037.96 | 1 333.54 | 377.26 | 916.78 | 1 294.04 |
| 1997 | 304.40 | 915.71 | 1 220.12 | 381.37 | 927.02 | 1 308.39 |
| 1998 | 304.46 | 915.89 | 1 220.35 | 374.79 | 865.59 | 1 240.68 |

* Usage charges are deflated by the number of calls. Due to breaks in the time series, Mexico and Greece are excluded from the OECD average. US information is not available for 1998.
*Source:* OECD and EURODATA.

## 4. CONCLUSIONS AND RECOMMENDATIONS

### 4.1. General assessment of current strengths and weaknesses

The Netherlands has made steady progress in telecommunications market liberalisation in the 1990s in conformance with the EU Directives, and is now one of the leading performers in terms of implementing the principles of the EU Directives.[39] In some policy areas such as interconnection and number portability, the Netherlands has gone further than EU requirements. While some asymmetric regulations remain, the Act removes unnecessary regulations such as line of business restrictions and unfair burdens arising from universal service obligations. The task now is effective implementation of this regulatory framework in a market where the incumbent is still dominant, and how to address challenges arising from the convergence between telecommunications and broadcasting.

The Netherlands has appropriate regulatory safeguards which ensure fair competition between the incumbent and new entrants. For instance, the Act has strong rights-of-way provisions and requires facility sharing between operators. In addition, number portability, including mobile service and carrier pre-selection will soon be implemented. These regulatory safeguards help new entrants to have a level playing field with the incumbent by means of equal access to customers as well as less initial cost in market entry.

The Netherlands has an advantage in infrastructure competition due to its ubiquitous CATV network which can be used as an alternative to the incumbent's bottleneck facility *i.e.*, the local loop. The Netherlands decided to take advantage of this by permitting CATV companies to enter into telecommunications markets as early as 1996 through interim legislation and by requiring KPN to reduce its stake in Casema in 1997. Together with the development of technologies which enable companies to provide less expensive local access through wireless local loop, the use of CATV networks for telecommunications will lead to increased network capacity, suitable for delivering multimedia and Internet services to end users.

Box 3. **Strengths**

- Full implementation of EU Directives.
- No entry and line of business restrictions.
- Appropriate regulatory safeguards ensuring fair competition between the incumbent and new entrants.
- Existence of alternative infrastructures.
- Strength and high quality of new competitors.
- Narrowly focused universal service requirement relying primarily on market forces.

As discussed earlier, the Netherlands has a focused and targeted universal service obligations. The experience of other OECD countries indicates that the funding of broadly-defined universal service entitlements through levies on the telecommunications industry can reduce efficiency and undermine other policy goals. In addition, while the Netherlands has a mechanism to ensure universal service, it opens the possibility that the development of effective competition will ensure universal service to all customers without using a special funding mechanism. Considering new strong entrants in the fixed voice telephony market and rapid growth of the mobile market, this "wait and see" approach to universal service provision seems very sound.

To large extent, effective competition depends on the quality of the new entrants. It is notable that in the Dutch telecommunications market, most entrants are high profile operators spawned from a combination of big domestic companies such as ING Group, the Dutch Railway and ABN-Amro, and large foreign telecommunication companies including Vodafone, BT, and France Telecom.

Box 4. **Weaknesses**

- Ministry retains regulatory powers in interconnection, numbering, universal service and licensing.
- The uniform tariff obligation on KPN restricts cost oriented pricing.
- No explicit provisions governing forbearance and withdrawal from regulation.
- Government remains a major owner in the sector.
- Fragmented regulatory regime between telecommunications and broadcasting.

While, in general, regulatory reform in the Netherlands is to be commended, there are some problems, which if not successfully addressed, will impede the future development of competition in the Dutch telecommunications market:

*a)* First, under the Act, the Ministry will retain certain regulatory functions in interconnection, numbering, universal service and spectrum licensing which are better handled by a transparent, independent regulator such as OPTA.

*b)* Second, the uniform tariff obligation on KPN restricts cost-oriented pricing. In addition, it prevents price competition in the marketplace by reducing the flexibility of KPN in taking the lead in setting prices.

*c)* Third, although there is provision for a "review" of the existence of OPTA in 2002, the details of this review are unclear. There should be explicit arrangements for assessing the level of competition in the market with a view to forbearing from further regulation.

*d)* Fourth, the Dutch Government has participated in the marketplace both as a player and a regulator. The problem is amplified by the fact that the Ministry still has regulatory power in interconnection, numbering, universal service, and licensing.

*e)* Finally, as a result of convergence, telecommunications and broadcasting are increasingly becoming part of the same industry. Fragmented regulation in these areas restricts companies and users from taking advantage of the benefits of convergence. This will become an increasingly pressing issue.

### 4.2. Potential benefits and costs of further regulatory reform

As this report has emphasised, despite the weaknesses identified above, the outlook for competition in the Dutch telecommunications sector is good.

But the telecommunications industry is subject to rapid technological change. New products and services are developed all the time. Unless the regulatory regime is consistent with such change, the regulatory regime may slow the growth of competition and hinder progress.

Even though the Netherlands just finalised the changes to the regulatory framework necessary to move the telecommunications market from monopoly to a competitive market, it should now begin preparing for a "new generation" regulatory framework which can facilitate and deliver the benefits of convergence. Market players are already exploring and committing to strategic alliances, joint ventures and mergers to materialise the commercial opportunities stemming from convergence. If the Dutch Government fails to develop an appropriate regulatory framework it will cause distortions including impediments to market development, investment, pricing and service enhancement. Considering the lengthy procedure of Dutch regulatory changes, it is timely to start discussion on this issue. While the right regulatory framework in the era of convergence is a complex issue, it is of critical importance for access to new services, lower prices, new business opportunities, economic growth and new jobs.

### 4.3. Policy options for consideration

The following policy options are based on the "Policy Recommendations for Regulatory Reform" set out in the *1997 OECD Report on Regulatory Reform*.

***Review regulations systematically to ensure that they continue to meet their intended objectives efficiently and effectively.***

Ministers have recommended that governments review proposals for both new and existing regulations. With the implementation of the new Act, the Netherlands will have a liberal, open regime for telecommunications. However, as convergence brings the telecommunications and broadcasting industries closer together, the differences in regulatory treatment will introduce distortions in investment and competition. *The regulatory regime for broadcasting should be reviewed, in the light of convergence, as soon as possible. In the long term, it would be preferable to create a single regulator to supervise all of the communications sector. In the short term, it is recommended that closer co-operation should take place and the determination of common policy goals between regulatory institutions in the broadcasting sector.*

Ministers have also recommended that regulations should be updated through automatic review methods such as sunsetting. Although there is a provision to review the existence of OPTA in 2002 by Parliament, the details of that review (such as its scope) remain unclear. International best practice calls for regular reviews of regulation, with a view to forbearance, by an independent agency. Such a forbearance review should carefully weigh the costs of continued regulation against the potential benefits of constraining the exercise of market power by a formerly regulated firm. *The Netherlands should therefore clarify the objectives and scope for the scheduled review of regulation. The review should include an explicit cost-benefit analysis of continued regulation.*

***Ensure that regulations and regulatory processes are transparent, non-discriminatory and efficiently applied.***

In the OECD report, Ministers recommended that procedures for applying regulations be transparent, non discriminatory, contain an appeals process and do not unduly delay business decisions. Under the present rules, much responsibility for interconnection, numbering, universal service and granting spectrum licences remains with the Ministry. It is important that these regulatory functions be carried out in a transparent and non-discriminatory manner. Although the Ministry should retain responsibility for policy matters such as the overall frequency plan, *remaining regulatory responsibilities for interconnection, numbering, universal service, and granting spectrum licences should be delegated to OPTA.*

***Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy.***

Ministers have recommended that sectoral gaps in coverage of competition law should be eliminated, unless compelling evidence suggests that public interests cannot be served in better ways. Ministers have also recommended that competition law should be enforced vigorously where collusive

behaviour, abuse of dominant position, or anti-competitive mergers risk frustrating reform. As competition develops, the NMa's role in telecommunications sector will be increased. *Government should ensure that competition law applies to this sector in cases of merger, abuse of market power and anti-competitive behaviour in order to ensure consistent application of competition rule across all industries.*

***Reform economic regulations to stimulate competition, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests.***

Ministers have recommended that governments review, as a high priority, those aspects of economic regulations that restrict entry, exit, pricing, output, normal commercial practices, and forms of business organisation. Although the new Dutch telecommunications regime will be relatively free of restrictions on entry and exit, certain constraints on prices remain. The requirement on KPN to retain uniform tariffs will hinder its ability to compete, will promote inefficient entry and will limit the extent to which the benefits of competition are passed on to consumers. *The restraints on KPN to retain uniform pricing should be lifted when consumers in rural area have sufficient choices for telecommunications services in any form, in favour of allowing cost-oriented pricing which benefits consumers.*

The Netherlands has imposed a temporary rate-of-return price regulation on KPN's fixed voice telephony and leased line services in order to establish a reasonable starting point for price caps. *OPTA should not delay to re-introduce price-caps in 1999 since* rate-of return regulation can generate undesirable incentives for inefficient behaviour.

# NOTES

1. OECD, *Communications Outlook 1999,* Paris.
2. OECD, *Communications Outlook 1999,* Paris.
3. OECD, *Communications Outlook 1999,* Paris.
4. There are two types of EU directives. One is the liberalisation directives which aim to remove exclusive rights and most special rights in the European telecommunications services and equipment market. The other is the harmonisation directives which intend to ensure fair competition in the European telecommunications market. See Annex Tables 2 and 3 for the implementation of EU Directives by the Netherlands.
5. The interim legislation is composed of the Fixed Infrastructure Act, which is the amendment of the Telecommunication Facilities Act of 1989, and the Fixed Infrastructure Licensing Act.
6. ONP rules require infrastructure companies have to charge uniform and cost based prices for network use and provide open access. Open access means that access should be provided on transparent, publicly disclosed, and equal terms.
7. Information Society Project Office of the European Commission, "Alternative Networks", April 1998.
8. In 1993, Swisscom of Switzerland became a partner of Unisource. In 1994, Unisource formed a joint venture with AT&T, called AT&T-Unisource Communications Service. Unisource is also a founding equity partner with AT&T, KDD of Japan and Singapore Telecom of the WorldPartners Company.
9. Most of its revenues come from licence and registration fees, and from its disputes resolution role among market players .
10. There are agreements between the Ministry and OPTA in the areas of exchanging information and "code of conduct".
11. See background report on The Role of Competition Policy in Regulatory Reform for more detailed information on the NMa.
12. Among other reasons, the Minister should revoke a license if it is required for compliance with a binding decision of an institution of the European Union, or for compliance with conventions and decisions of international organisations which are binding on the Netherlands.
13. Local municipalities do have a co-ordinating role in deciding when to open up the streets.
14. In general, OPTA designates the telecommunications service providers who have more than 25 per cent market share in fixed public telephone network and fixed public telephone services market, mobile public telephone networks and mobile pubic telephone services market, and leased lines market. Nevertheless, following the EU interconnection directive, OPTA may designate providers having a share of less than 25 per cent in the different markets as providers with significant market power, or not designate providers having a share of more than 25 per cent in the particular market as providers with significant power on the relevant market.
15. The cost accounting system needs to be approved by OPTA.
16. The European Commission recommended that NRAs should set deadlines for implementation by incumbent operators of new cost accounting systems based on current costs and activity-based accounts.
17. See discussion in Section 2.2.7, second paragraph.
18. Previously the carrier-select tariffs of KPN were 7.1 cent per minute and 8.3 cent per minute for regional and national traffic, respectively. OPTA's decision results in tariffs close to those currently charged by KPN for terminating access, at present 3.3 cent per minute and 4.2 cents per minutes, respectively. Theoretically OPTA's decision is in line with the concept of network externality. When network connections increase owing to low interconnection charges, each subscriber can reach more individuals and is thus prepared to pay more for subscription fees.

19. Telephony tariffs are based on usage time subscription fee and leased lines have flat rate, distance-dependent tariffs.

20. According to OPTA, KPN has to offer voice telephony at cost oriented tariffs for eight services:

    1. Access (problems concerning the connection network)
    2. International traffic
    3. National (inter- local) traffic
    4. Local/regional traffic
    5. 0800/090x traffic
    6. Traffic between the mobile and the fixed network
    7. Phone boxes
    8. ISDN

21. KPN offers a low user scheme called "Bell Budget" which has low monthly rental fee and relatively high call charges.

22. The Netherlands has imposed 10% rate of return regulation on CATV companies. (CPB, "Competition in Communication and Information Services", 1997).

23. On its press release on auctioning DCS 1800 frequencies the Ministry said "Through the auction process scarce resources are obtained by those companies which believe they can realise the greatest economic return on investment. In previous frequency distribution for mobile telephony in 1995, use was made of a "comparative assessment procedure". In practice, the competing offers were very close to each other. This comparative assessment procedure also requires the government to have a clear view as to the most desirable package for the market. The auction system is far more transparent and provides more scope for business to determine the final use of the frequencies."

24. There were five applications for the two licences regarding the establishment of a national mobile telephone network with DCS 1800 frequencies, combined with GSM frequencies. Deutsche Telekom/France Telecom/ABN-Amro/ Rabobank and Telfort (BT/NS) were granted the licences which they bid NLG 600 million and 545 million respectively.

25. Number portability is the term used to describe the ability of customers to retain their telephone number if they change service supplier.

26. In results of the study, a steering committee comprising five operators and two working groups (technical and customer care) have been set up.

27. Carrier pre-selection is defined as a mechanism which allows users to pre-select the long-distance or international traffic carrier of their choice on a permanent or default basis. Customers can override their pre-selected carrier by dialling a short access prefix.

28. At EU level, no requirement is imposed on member states to set up national schemes to share any burden among market players which may result from the cost of universal service provision.

29. The cost of universal service depends on population density and shape of landscape. Considering high population density in the Netherlands and flat landscape, it is expected that the cost of universal service is not high.

30. The companies which provide the services, designated as universal service and the companies which have a higher turnover for the service in the Netherlands than the amount stipulated by ministerial regulation in the calendar year share the cost.

31. Article 16 of the competition law provides that the competition law does not apply to agreements that are subject to the approval of another administrative agency pursuant to other legislation, that could be declared invalid or prohibited by another agency, or that have arisen pursuant to another statutory requirement.

32. The Act defines broadcasting as "an electronic media service concerned with the provision and broadcasting of programs" and broadcasting network as "technical installations, or parts thereof, that are used to broadcast programs by means of cables or radio connections between points, to one or more pieces of land, dwellings or non-residential buildings".

33. However, point-to-multipoint terrestrial broadcasting is controlled by NOZEMA, a limited liability company with shares owned by State and public radio and TV broadcasters.

34. Casema and A2000 started offering Internet service via the cable in Delft on October 1997. As of November 1997, cable company Telekabel offer its subscribers unlimited access to the Internet at a price of around US$26 per month. As of March 1998, Castel offers free access to the Internet in certain regions using KPN's infrastructure.

35. KPN launched GSM service in July 1994 and Libertel launched GSM service in September 1995.

36. By the end of 1997, Libertel served 532 000 subscribers. KPN has about 1.2 million subscribers at the end of 1997. The analogue service was launched in 1980 and the subscriber numbers are stabilised at around 258 000. GSM service served 924 198 customers by the end of 1997. KPN's monthly access charge is a little bit higher than that of Libertel's but its per call charge is lower than that of Libertel's.

37. In January 1998, Vodafone increased its stake in Libertel to 61.5% by agreeing to buy out all of Libertel's minority shareholders as well as part of the ING holding for US$ 438.5 million.

38. Only Iceland, Luxembourg, Sweden, and Norway have lower business tariff basket than the Netherlands.

39. According to the European Commission "Third report on the implementation of the telecommunications regulatory package (January 1998)", the Netherlands has implemented all liberalisation and harmonisation directives except for licensing and interconnection directives, which are only partially implemented due to delay of the Act enactment.

# ANNEX TABLES

Table 1. **Liberalisation of the European telecommunications market**

| | |
|---|---|
| 1984 | Decision to begin work on a Green Paper on the role of telecommunications in the construction of Europe. |
| 1987 | Publication by the European Commission of the Green Paper on European telecommunications. |
| 16 May 1988 | Terminal Directive (88/301/EEC) allowing for competition for terminals, including telephones. |
| 7 December 1989 | Decision by the European Council of Ministers to progressively open most telecommunications services to competition, with reservation of the exclusive and special rights on the telephone service between fixed points and on the public infrastructures. |
| 28 June 1990 | Service Directive (90/388/EEC) allowing for competition for telecommunications services except the telephone service. |
| 1 January 1993 | Competition in the data transmission services domain. |
| 16 June 1993 | Decision by the European Council of Ministers to extend competition to all telecommunications services from 1 January 1998. |
| 17 November 1994 | Decision by the European Council of Ministers to widen competition to infrastructures from 1 January 1998. |
| 16 January 1996 | Mobile and Personal Communications Directive (96/2/EC) allowing for competition in mobile telephony. |
| 13 March 1996 | Full Competition Directive (96/19/EC) modifying Service Directive (88/301/EEC) to draw up the calendar and conditions for the extension of competition. |
| 1 July 1996 | Competition for alternative infrastructure. |
| 1 January 1998 | Competition for the provision of telephone service open to the public and for the underlying infrastructure. |

*Source:* European Commission.

Table 2. **Implementation of EU liberalisation directives by the Netherlands**

| Liberalised activity | Dutch provision (date in effect) | EU Directive (implementation dead line) |
|---|---|---|
| Circuit and packet switched data transport services | Ministerial Decree (1993) | Service Directive (1990) |
| Voice telephony within closed user groups | Ministerial Decree (1994) | Service Directive (1990) |
| Simple resale of leased lines capacity | Ministerial Decree (1993) | Service Directive (1990) |
| Mobile network and communications services | Mobile Telecommunications Act (1994) | Mobile and Personal Communications Directive (1996) |
| Satellite network and communication services | Fixed Infrastructure Act (1996) | Satellite Directive (1994) |
| Use of cable television infrastructure for telecommunications purposes | Fixed Infrastructure Act (Aug. 1996) | CATV Directive (January 1996) |
| Use of other alternative fixed infrastructure for telecommunications purposes | Fixed Infrastructure Act (Aug. 1996) | Full Competition Directive (January 1996) |
| Installation and exploitation of new fixed telecommunications infrastructure | Fixed Infrastructure Act (1996) | Full Competition Directive (1998) |
| Voice telephony services | Fixed Infrastructure Act (July 1997) | Full Competition Directive (January 1998) |

*Source:* European Commission.

Table 3. **Implementation of EU harmonisation directives by the Netherlands**

| Liberalised activity | Dutch provision (date in effect) | EU Directive (implementation dead line) |
|---|---|---|
| Creating independent regulatory body | OPTA Act (Aug. 1997) | ONP Framework Directive (December 1996) |
| Designating operators with significant market power | Telecommunications Act | Interconnection Directive (December 1997) |
| Implementation of cost accounting system | Telecommunications Act | ONP Framework Directive (December 1996) |
| Authorisation procedures for voice telephony and public telecommunications network | Fixed infrastructure Act (1996)<br>Telecommunications Act | Licensing Directive (December 1997) |
| Publishing interconnection terms and conditions | Telecommunications Act | Interconnection Directive (December 1997) |

*Source:* OECD.

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