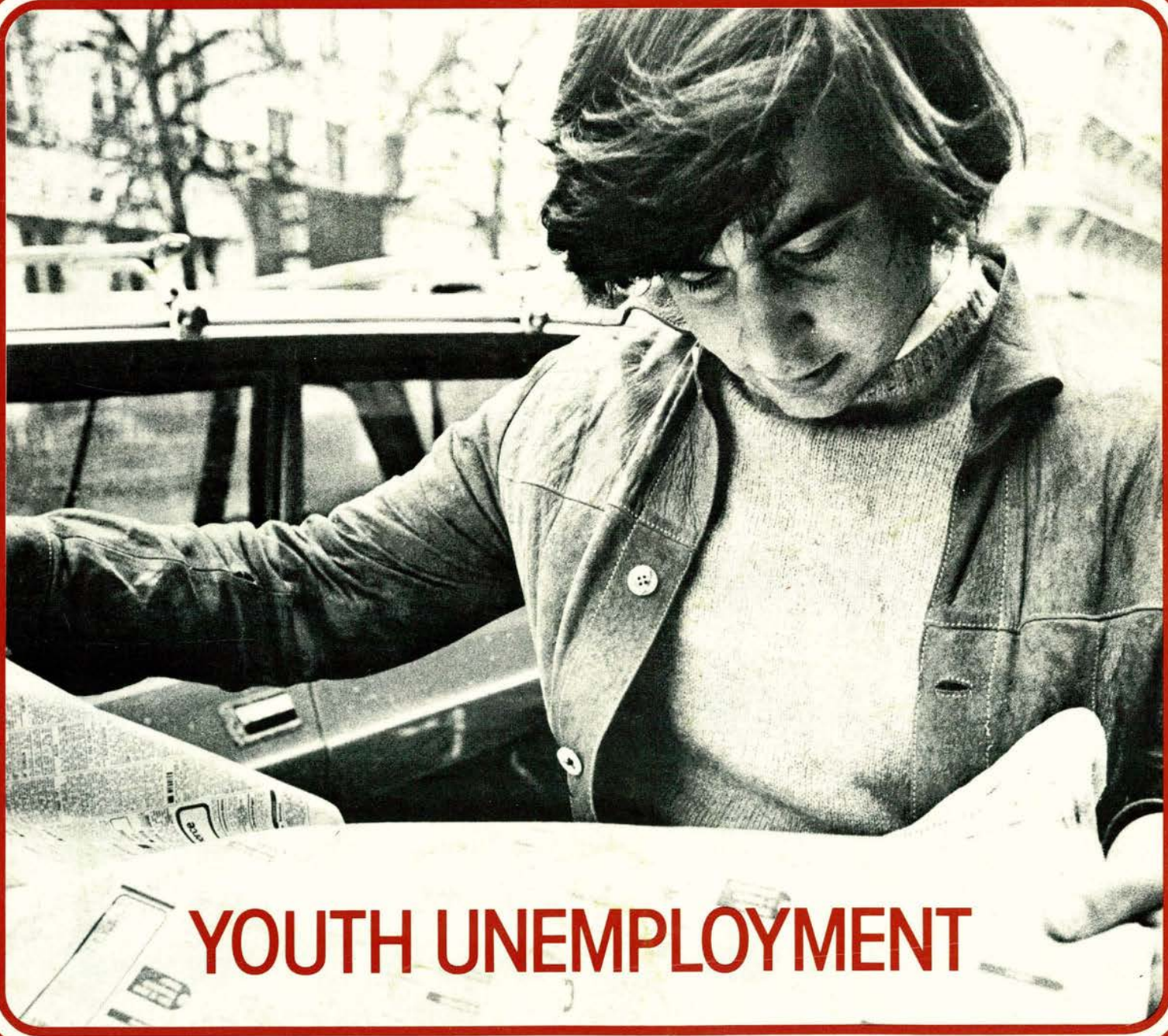
the OECD OBSERVER



YOUTH UNEMPLOYMENT

N° 90/JANUARY 1978

Contents

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YOUTH UNEMPLOYMENT
OECD MINISTERS DISCUSS POSSIBLE SOLUTIONS*

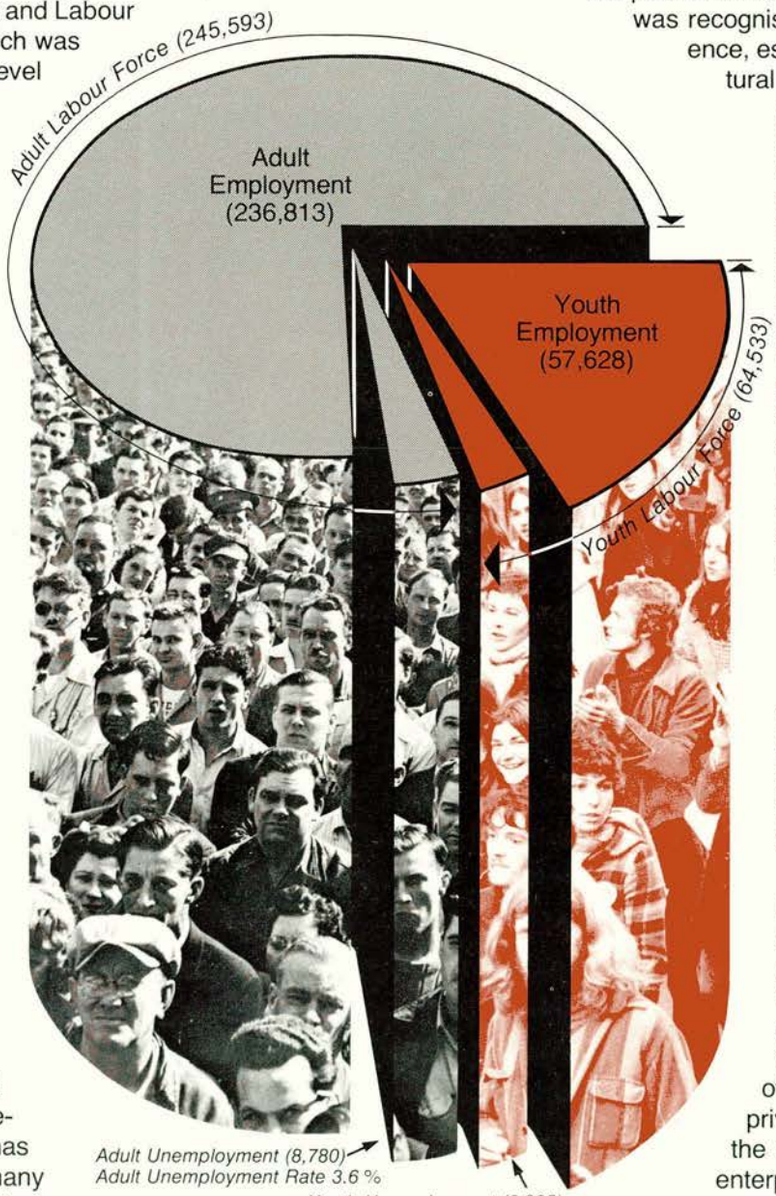
The urgent problem of youth unemployment was discussed at a High Level Conference at OECD Headquarters on 15th and 16th December, 1977, under the Chairmanship of the Honorable Ray Marshall, Secretary of Labor of the United States. The Vice-Chairmen of the Conference were Mr. Leif Aune, Minister of Labour and Municipal Affairs of Norway, and Mr. Guy Spitaels, Minister of Employment and Labour of Belgium. The Conference, which was attended by Ministers and high-level officials, was convened in accordance with a decision of the OECD Ministerial Council in June 1977.

The purpose of the Conference was to exchange experience on measures that have been adopted or planned in Member countries to combat youth unemployment.

Recognising that youth unemployment is a challenge, not only for governments but for society as a whole, the Conference welcomed the fruitful consultations with the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) prior to the Conference, and the positive statements provided by them concerning the contributions that could be made by employers and trade unions.

Causes

The Conference recognised that youth unemployment resulting from a combination of slower rates of economic growth, demographic trends and structural factors affecting the demand for and supply of labour, has reached serious proportions in many countries, young people having been hit more severely than other groups. Unemployment is wasteful, but youth unemployment has particular human, social and economic consequences which no nation can accept, the more so because of the important role to be played by the younger generation in the future development of our countries.



A. YOUTH AND ADULT LABOUR FORCE AND UNEMPLOYMENT
THE 1976 SITUATION IN THE OECD*
in thousands

Total Labour Force	310,126
Ratio of Youth to Adult Unemployment Rate	3.0

* *Figures exclude Turkey.*
Source: Secretariat estimates.

The Conference underlined that the creation of new jobs was greatly dependent upon the rate of the economic recovery and, therefore, upon an appropriate implementation of the OECD medium-term strategy defined by the OECD Council at Ministerial level in 1976 and 1977.

The pattern as well as the rate of economic growth was recognised as important by the Conference, especially for countries with structural employment problems. It was pointed out that a wide range of policies—for example industrial, regional and investment policies—could be mustered to achieve adequate levels of employment and labour mobility, taking into account their effects on regional and international employment opportunities. The participants in the Conference agreed that there was a need for a continuing review of these matters at the international level and invited the OECD to take them into account in its review of medium-term growth prospects.

Solutions

In order to solve the problem of youth unemployment, special measures, in conjunction with economic growth, will continue to be needed for some years to come.

Measures already taken in Member countries to reduce youth unemployment cover a wide field (see page 9). They include:

- the introduction of incentives for the creation or maintenance of jobs for young people in the private sector. In this connection, the role of small and medium-size enterprises was emphasized
- the creation of jobs in the public sector in response to urgent social needs in fields such as health, social services, adult education and environmental protection
- public support for local community projects, outside traditional public structures

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* *Communique of the Ministerial Conference.*

"We have learned that there is no single panacea for the youth unemployment problem. Rather, what is needed is a broad mix of strategies aimed at different elements of the problem. In North America, for example, we rely on public service employment as a primary response to unemployment. In Europe, the emphasis is more on wage subsidies. Neither approach alone is likely to solve the entire problem. Instead, we should be more adaptable and innovative in fighting unemployment. Not by abandoning our existing programmes, but by examining the programmes of other countries in the hope of incorporating some of their features to complement and enhance our own efforts."

Ray MARSHALL, United States Secretary of Labour and Chairman of the Conference

"The Norwegian Government has aimed at providing a guarantee to all young people that they will be offered education, training or employment by the end of the next parliamentary period—that is, by 1981."

Leif AUNE, Minister of Labour, Norway, Vice Chairman of the Conference

"The aim is to help young people make a successful transition to working life with the least possible wastage in terms of wrong paths, failures, or time lost in "dead-end" experiences; to spare them the trauma of repeated disappointment, to help them become aware of their own creativity and increase the range of possible choices through a good supply of information."

Guy SPITAELS, Belgian Minister of Employment and Labour, Vice-Chairman of the Conference

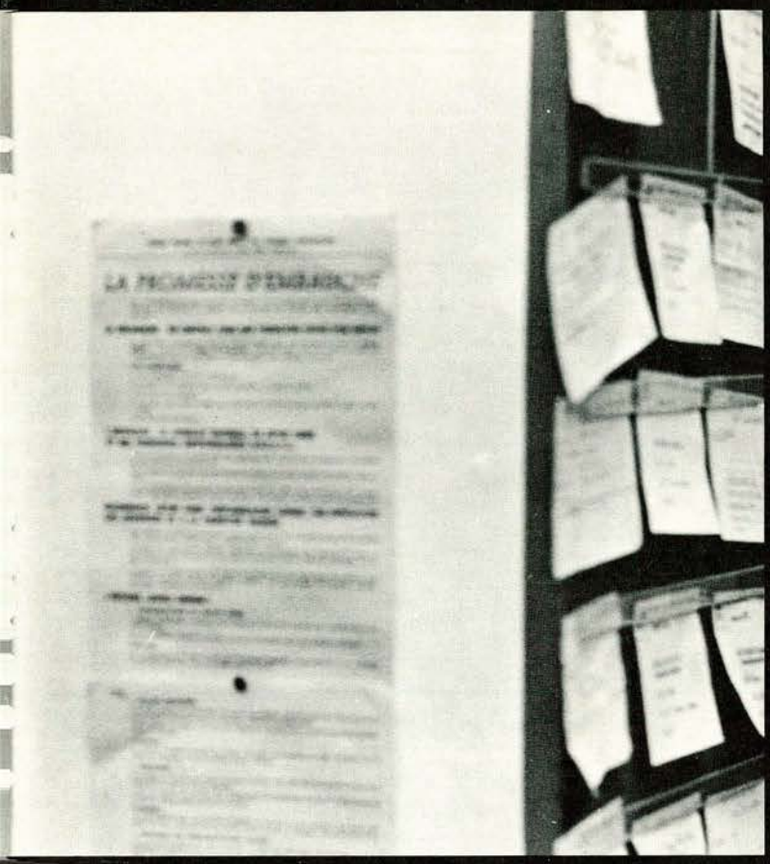
"Youth unemployment is a human, social and economic problem for which not only short-term solutions, but also lasting remedies, must be found. It is a challenge, not only to our social values and economic institutions—but also to our political will and foresight.

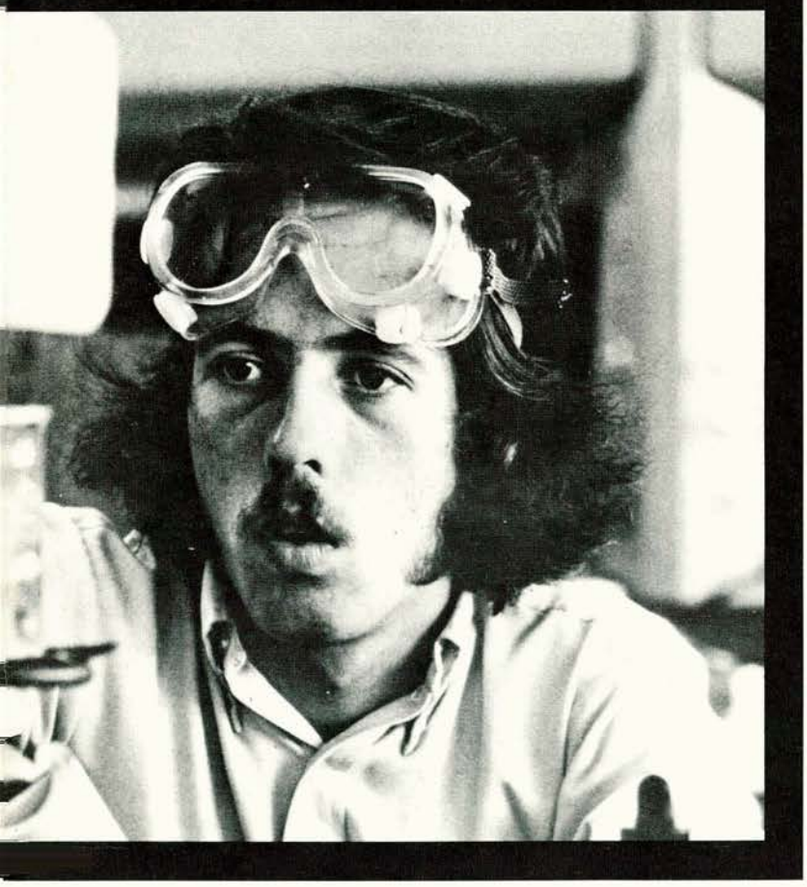
Emile van LENNEP, OECD Secretary General

- measures designed to develop various forms of training, including apprenticeships, both in enterprises and in institutions
- the reinforcement of established information, counselling and placement services
- special measures to help young people enter working life, including paid and unpaid work experience
- measures affecting the size of the labour force, such as extended education, paid educational leave or flexible retirement.

With reference to the above measures the Conference has singled out the special problems encountered in the European countries by young second generation immigrants, which require particular attention.

The Conference stressed that the choice and combination of measures and their implementation should be tailored to the





specific situation of each country. Such selective measures should be closely co-ordinated with general macro-economic policies, should be monitored and their effectiveness evaluated, so that they can be adapted as the economic recovery proceeds. They should be developed in co-operation with bodies representing workers and employers and with the participation of young people themselves. Positive results have already been achieved in certain countries in the context of an active employment policy involving firms, trade unions and employers' associations and government departments.

While efforts to improve the level and quality of general education should be pursued, the Conference emphasized the need for measures to strengthen links between education and working life. The transition from school to work can be eased by government-industry co-operation to provide a combination of training and work experience, more extensive use of apprenticeship schemes, and by more active co-operation between guidance and labour market services. The educational system can also contribute by preparing young people for community life and the world of work, bridging the gap between general and vocational education, and more flexible post-secondary education and training to meet the changing needs of individuals and the economy. The Conference recognised the need for those who leave school early to have later educational and training opportunities, and also the special career and educational needs of groups, harder hit within the context of youth unemployment, such as women.

Action by employers, trade unions and governments to adapt the quality of working life to the aspirations and capacities of young people and to enhance the value of manual work would also make a contribution to solving the problem.

Some countries are considering the possibility of a more equitable sharing of the available employment opportunities as a means of creating additional jobs for youth. The measures being considered or already taken include reductions of working time, voluntary earlier or phased retirement, increased opportunities for continued education and more flexible employment patterns. There was a diversity of views on the merits and the effectiveness of such measures. However, it was generally agreed that the social and economic implications of such changes were both complex and uncertain—in particular with regard to their reversibility—and that they were not a substitute for efforts to provide employment for all.

The Conference recognised that a number of factors in the operation of labour markets may impede the employment of youths. The extent of preference of employers for more experienced workers, the impact of differential wage rates for youths and other categories of employees, labour market entry barriers, the relative productivity of young workers versus adult workers, are among those factors which require further study by Member countries in co-operation with the OECD. It was agreed that they should be studied as a means of a better understanding of youth employment problems and of developing more effective youth employment policies.

Some countries stressed the need for structural changes in the economy if fundamental solutions to unemployment, including youth unemployment, are to be found. Whilst adhering to such views, other countries felt that a social guarantee of education, training or work for all youth constitutes an objective to be achieved in order to ensure their meaningful integration into working life.

In conclusion, all countries agreed that progress towards the full employment objective, in accordance with the 1976 OECD Recommendation on a General Employment and Manpower Policy, would be promoted by action in three main directions:

- the creation of jobs through increased economic activity, whenever possible
- the intensification of special measures to increase employment opportunities for youth and without weakening existing labour protection of young workers
- an improved transition from school to work.

Since the problem of youth unemployment is, to a large extent, common to Member countries, the Secretary General was invited to submit, to the OECD Council, proposals for appropriate follow-up to the Conference.

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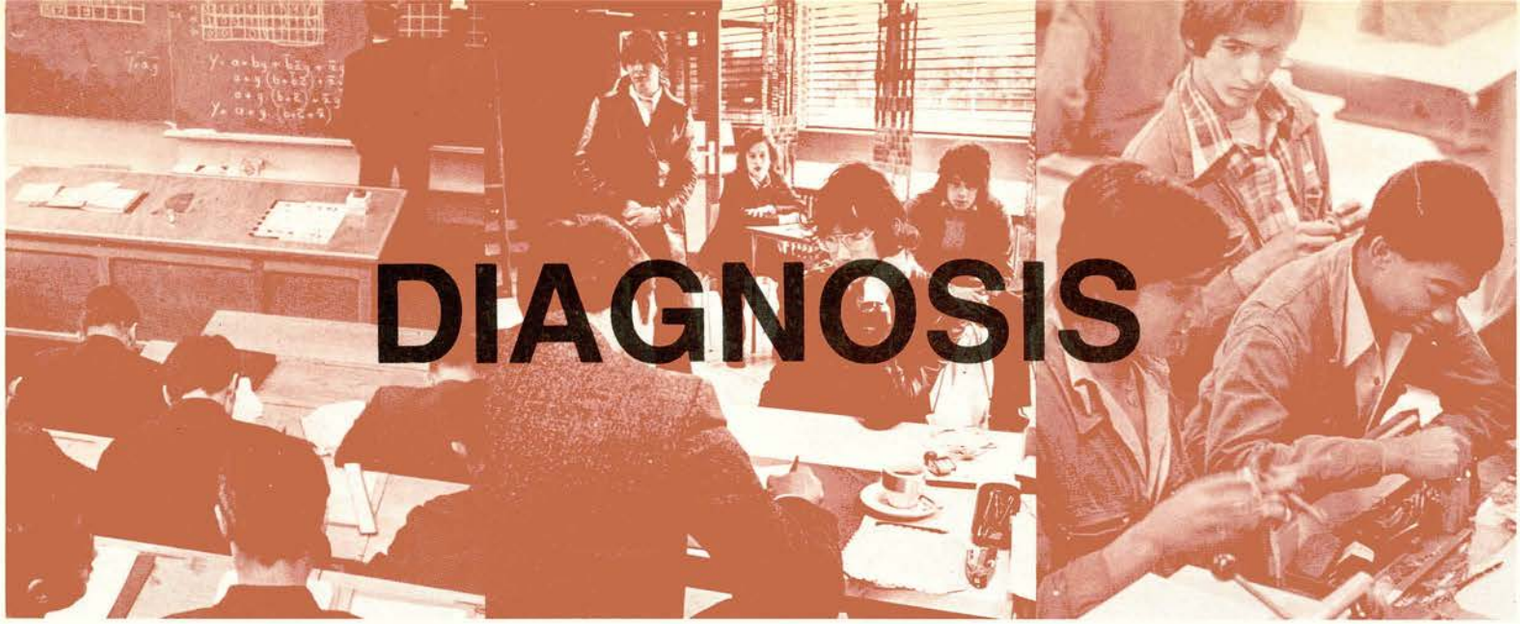
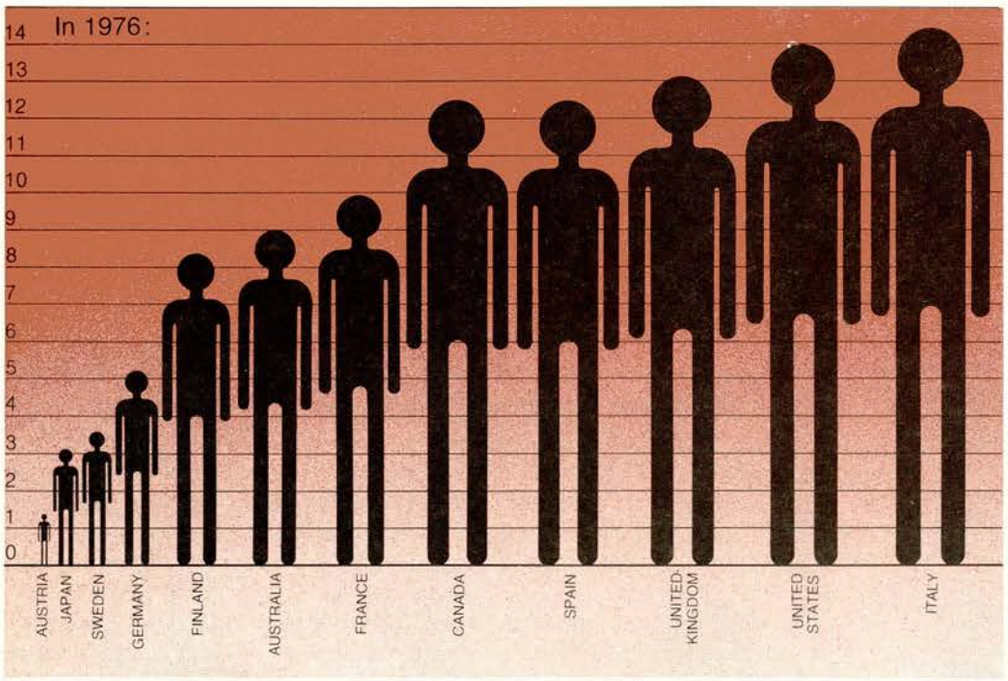


DIAGNOSIS

B. YOUTH UNEMPLOYMENT RATE, 1960-1976 %



	1960	1965	1970	1973	1975	1976
Australia	..	1.7	2.5	3.8	(8.9)	9.0
Austria[e]	..	..	1.4	1.4	1.4	(1.4)
Canada[h]	10.6	6.3	10.3	9.7	12.2	12.5
Finland[i]	..	(2.3)	3.0	4.5	4.3	(8.3)
France	1.6[b]	..	1.5	2.9	7.6	(9.9)
Germany[g]	0.7	0.2	0.3	1.0	5.8	(5.2)
Italy[c]	3.3	8.7	10.2	12.6	12.8	(14.4)
Japan	1.4	..	1.9	2.2	3.0	3.1
Spain	..	1.8[a]	2.3	6.7	10.5	12.5
Sweden[d]	..	2.6	2.8	5.3	3.6	3.6
United Kingdom[f, j]	(1.1)	1.2	2.7	(2.9)	(7.4)	(13.1)
United States[d]	10.0	9.1	9.9	9.8	15.2	14.0

a) 1967.
b) 1962.
c) Rate for 14-24 year olds.
d) Rate for 16-24 year olds.
e) Youth aged less than 30, labour force aged 14-29 for the years 1960-73 and 15-29 for years 1975-76.
f) Youth aged less than 25, labour force aged 16-24.
g) Youth aged less than 25, labour force aged 15-24. Figures for 1960 and 1965 refer to 1958 and 1964 respectively.
h) Revised series from 1975; 1975 rate for the old series was 12.7.
i) Revised series from 1976.
j) Rate for Great Britain.
.. Not available.

Figures in parentheses are Secretariat estimates.

Sources: *OECD,* Labour Force Statistics, Quarterly Supplement, *various issues; OECD Statistics Service and national sources.*
For France, Germany, Japan and the United Kingdom, rates for the 1960s are not consistent with those for later years.

Four factors indicate the extent of the youth unemployment problem and its increasing gravity.

• *The extent of the problem.* Rates of youth (1) unemployment in excess of ten per cent, previously recorded only in North America, are now being experienced in Australia, Finland, Italy, Spain and the United Kingdom, with France not far behind For the OECD area as a whole (2), the 1976 rate was 10.7 per cent, in other words, there were 6.9 million unemployed young people: and the young accounted for 44 per cent of all the unemployed (see Chart A).

United States data show that, since 1950, for roughly comparable successive periods of labour market weakness, the youth unemployment problem has steadily worsened. A comparison of rates during peak years of the business cycle also show steady deterioration for Canada, France, Germany, Italy, Japan and the United States. The situation started to worsen significantly in the late 1960's, well prior to the oil crisis but at a time when a number of other labour market indicators were already declining.

• *Duration of youth unemployment.* Owing to the high turnover of young people in the labour market, their period of unemployment is generally short. For youth as well as for adults however, when unemployment rises in the aggregate, the duration of an average spell of unemployment generally lengthens. What was once seen as a difficult but brief transition is now becoming a prolonged period of sustained hardship. In the United Kingdom, for example, the

(1) Except where otherwise noted, the term "youth" includes those between 15 and 24 years of age. Data for the United States, the United Kingdom and Sweden refer to 16-24 year olds, for Italy to 14-24 year olds, and for Austria to persons less than 30 years of age.
(2) Excepting Turkey, for which no data is available.

median duration of unemployment for those under 18 was less than three weeks in 1970 and over 11 weeks in 1977—a faster increase than for adults. In France, 56 per cent of unemployed youth were jobless for 12 or more weeks in 1971, but by 1976 the number had increased to 68 per cent of a much higher total unemployment figure. In the United States, 35 per cent of teenage (16-19) unemployment lasted more than 15 weeks in 1976, as against 30 per cent in 1965.

• Owing to the growing magnitude and duration of the problem, *the effects of youth unemployment are extending to new groups of individuals.* What was once a problem limited to a relatively small number of young persons—mainly school dropouts—now affects the young at large.

• *The cost of youth unemployment* of the current magnitude *is considerable.* It burdens already strained transfer payment systems and represents a serious loss of human capital investment. Youth unemployment also obviously generates pressures on political and social structures. It means not only lost output but also losses in the form of training which never takes place, negative rather than positive work histories, and labour force experience showing the unmistakable signs of early failure. A significant number of the younger generation will reach maturity without ever having had a meaningful job experience. It is impossible to predict the magnitude of the longer-term effects, but they are bound to be considerable.

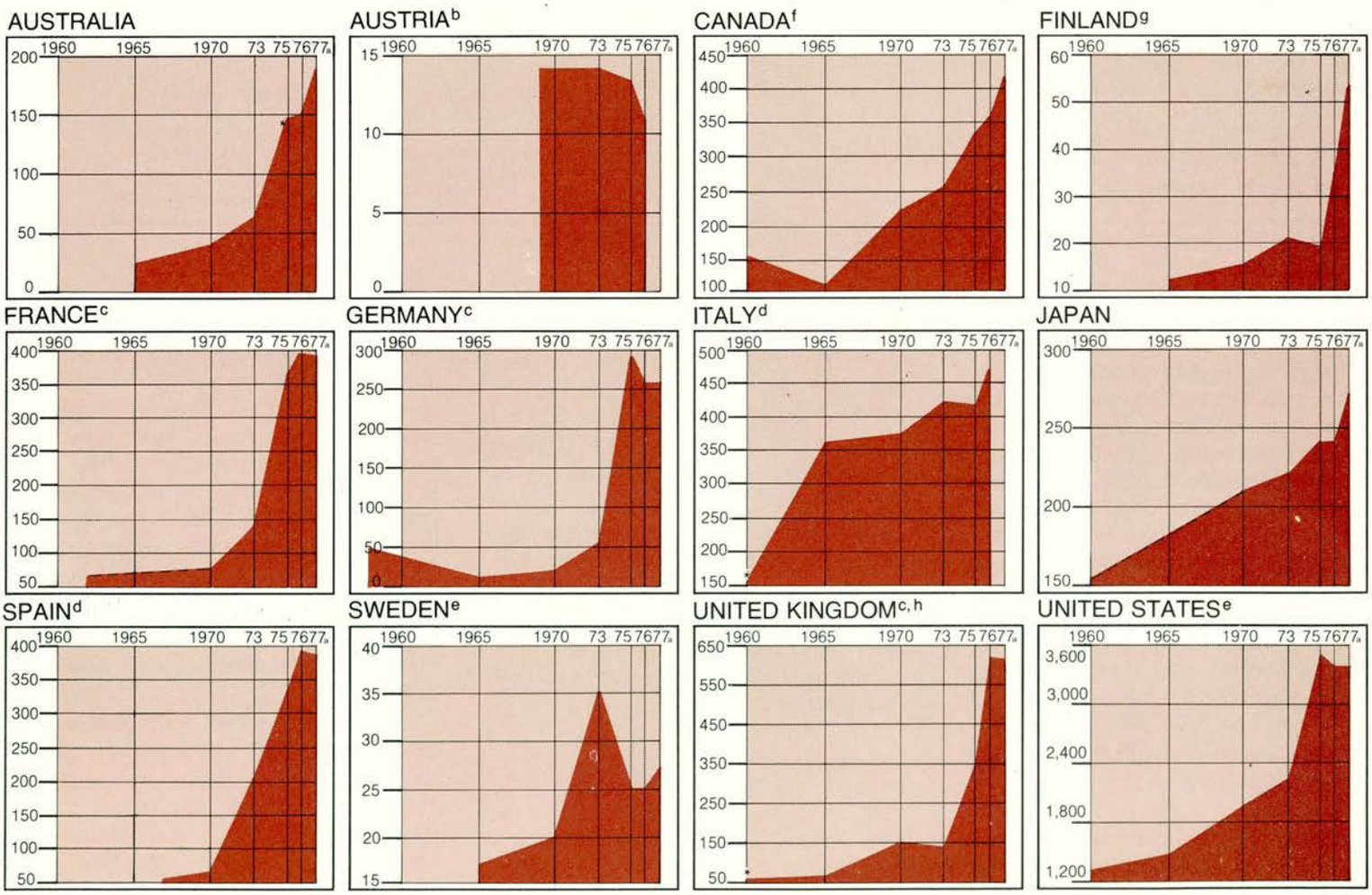
Causes

Several factors explain the emergence of this problem. The slack in aggregate demand has hit the labour market with a lag since, in their efforts to mitigate the recession, governments and enterprises have cushioned the impact of unemployment without dealing with the causes by, introducing shorter working hours, for example. Although economic policy in some countries is becoming more expansionary, its impact on the labour market will also be felt with a lag because of the large amount of slack which already exists. Measures to protect those already employed nave inevitably had some negative consequences for youth, since it is they, who in the main are the entrants into the job market. Those who already have jobs are more reluctant to risk a change; this reduces labour turnover and thereby opportunities for youth.

This is not to imply that the current difficulties are merely a historical accident. The effects of rapid increases in labour supply during a period of shrinking demand could have been foreseen and to some

C. UNEMPLOYED YOUTH AGED 15-24

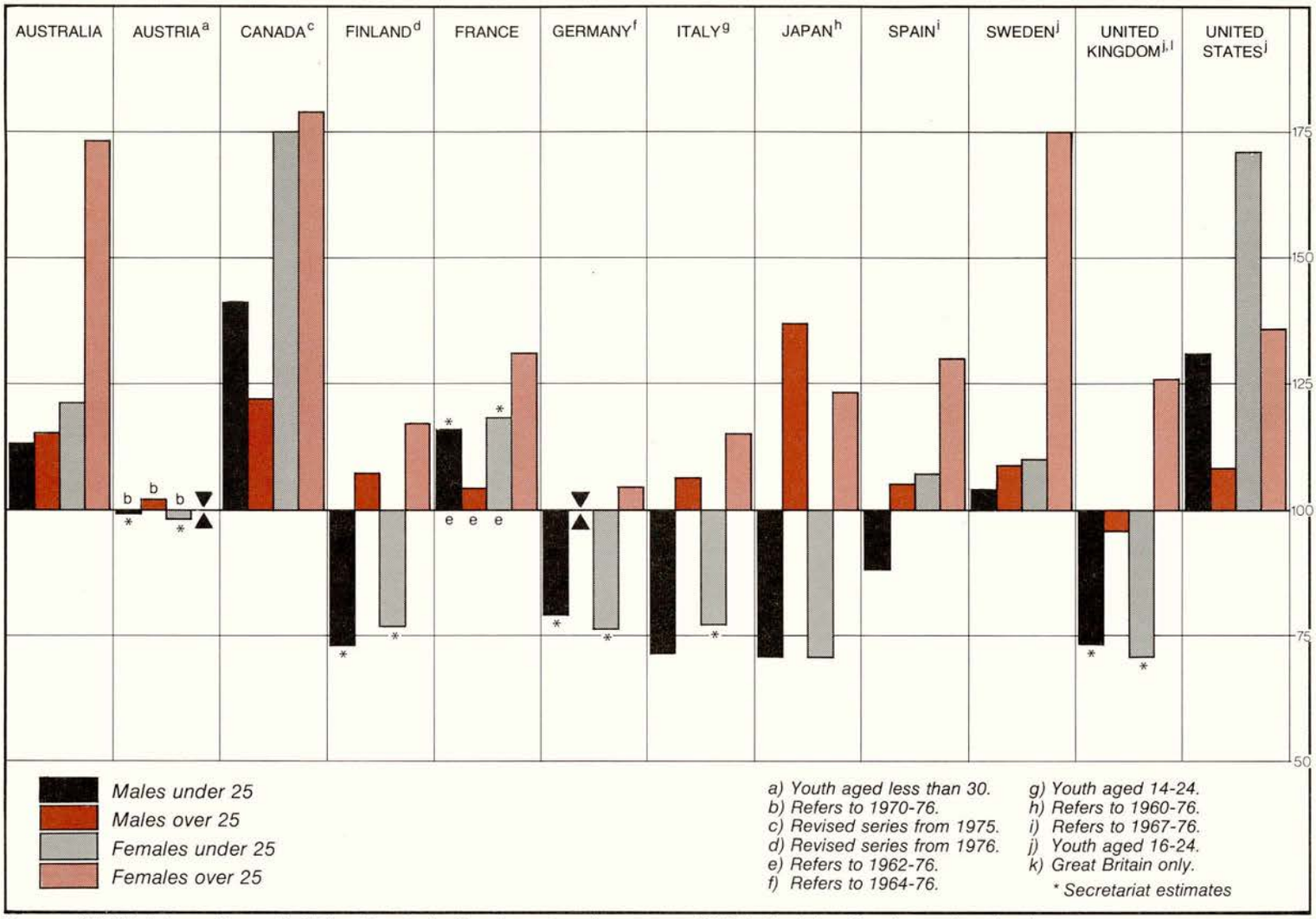
thousands



* *These figures are Secretariat estimates.*
a) First two quarters only.
b) Unemployed youth aged less than 30, adults aged 30 and over.
c) Unemployed youth aged less than 25.
d) Unemployed youth aged 14-24.
e) Unemployed youth aged 16-24.
f) Revised series from 1975, 1975 figures consistent with old series are 345 for youth and 364 for adults.
g) Revised series from 1976.
h) Figures are for Great Britain and exclude adult students seeking vacation employment.
Source: *See Graph B.*

D. CHANGE IN NUMBER EMPLOYED, 1965-1976

(1965 = 100)



Source: OECD Labour Force Statistics, Quarterly Supplement *various years, OECD Statistics Service and national sources.*

extent offset by relevant employment and education policies.

The available data do not permit quantitative distinctions between the various components of unemployment. It is known that cyclical conditions (depressed aggregate demand) account for much of the problem as do structural factors of which one of the most important is the demographic trend—arrival on the labour market of the large number of young people who were born during the post-war baby boom and the steep rise in the rates of female participation in the labour force. The relative importance of cyclical and structural influences varies widely from country to country, but certain structural elements are common to all:

- *Employer uncertainty* about the productivity of young people and their willingness to stay in a job. In the past, that uncertainty was of no consequence because of the need to fill specific job vacancies. In the current economic climate, however, employers have little incentive to incur the training costs normally associated with the employment of young people.

- *Work regulations* imposed by trade unions or governments. These increase the fixed nature of labour costs and thus drive a wedge between those lucky enough to have a job and the growing numbers of unemployed.

- *The inability of the educational system* to link human capital requirements to jobs.

- *Transfer programmes,* including unemployment benefits, which act as a disincentive for those young persons who would otherwise seek jobs in sectors with lower salary levels.

*
* *

The fact that aggregate demand and demographic patterns appear to be two of the principle culprits in the *current* situation implies that the problem of youth unemployment has a significant time dimension: both will change. Best current estimates suggest that somewhere between 1985 and 1990, depending on the country in question, the problem will become less intense. Nevertheless, a situation with at least a ten-year time perspective can in no way be called "transitory". Relevant policies will need to have immediate effects, and to be flexible and capable of being phased out or redirected. The problem's immediate and medium-term components appear to call for strategies which respond to the following criteria:

- A substantial increase in the number of jobs created in the short-term. This implies a mix of demand-management and selective employment policies over the next five to eight years.

- Within the overall approach, special employment and manpower programmes which can lead to meaningful work and career opportunities for youth, to be phased out as the economic recovery takes hold.

- The introduction of policies to deal with underlying structural issues remaining when the demographic and demand elements of the problem have diminished in ten year's time or so.

WHAT ARE OECD COUNTRIES DOING?

Impact and Effectiveness of the Measures Adopted

OECD governments have considerably extended the range of measures designed to deal with the problem of youth unemployment. Are they adequate? A comparative analysis can help to evaluate their effectiveness and to assess the strategies behind them.

Developing Job Opportunities

• *Stimulating employment in the private sector.*

Many OECD countries directly subsidise employment in firms in the private sector either to maintain or to create jobs. In this way, the employer can reduce the marginal costs of employment, while young workers continue to receive the wages set by current legislation or collective agreement. Countries generally justify these subsidies by pointing out that they help simultaneously to increase employment and to reduce inflationary pressure because the additional jobs create output as well as income and because the sums thus disbursed are offset by the extra yield from direct and indirect taxes, by social security revenue and by reduced expenditure on social benefits.

In several countries, the subsidies apply to all age-groups in the labour force: this is the case, for example, in Austria, New Zealand, Spain, Sweden and the United States. But in others the subsidies are aimed directly at the employment of young people (in Finland, France, Ireland, the Netherlands, Norway, Sweden and the United Kingdom). Such subsidies usually take the form of payments to the employer or exemption from social security charges. Under the 1977 Tax Reduction and Simplification Act in the United States, they take the form of reductions in corporate taxes which range from $630 to $1,806 per additional worker engaged in 1977 and 1978 depending on the tax rate; the Act also authorises the payment of wage subsidies to induce employers to hire participants in Youth Incentive Pilot Projects under the Comprehensive Employment and Training Act (CETA).

In several countries (e.g. Finland), the amount of the gross subsidy is the same as the unemployment compensation that would otherwise have been paid and is therefore somewhat less than the wages paid. In Sweden, the subsidy is 75 per cent of the wage costs but up to a maximum of only S.Kr. 10 per hour, far less than the going rate, so that the average is much less than 75 per cent. In many cases the minimum subsidy paid to employers is about one third of their gross wage costs (i.e. wages plus social security charges).

What should be the size and duration of the subsidy so as to provide the greatest financial incentive? The response from employers may well be slight at first if the subsidy is small compared with the wage costs, if it is not determined by agreement with industry itself or given wide publicity; such a programme must have a strong initial impact. In any case, employers will only be attracted by incentives affecting costs if they expect demand to recover.

When firms are given incentives to create jobs, it is important to ensure that there is a net increase in employment and not a mere subsidising of jobs that would have been created in any case. The substitution effect of subsidies may be twofold: firms may hire unemployed workers to replace other workers who then become unemployed themselves; or less stable and satisfactory jobs may take the place of permanent ones. To forestall this, various conditions have been imposed. In Ireland subsidies are granted only to enterprises which have increased their workforce over the January 1977 level. In France, firms receiving subsidies in 1977 must at least keep their employment level at the 1976 average.

In most countries, the most common practice is to pay subsidies only for the employment of young people who have been out of work for a certain time.

The jobs subsidised may be temporary or permanent ones, but to ensure that the enterprise is not permanently supported (and also to obtain a quick response), the subsidy is usually limited to a certain number of weeks or months (up to 12 months in France, 6 months in Ireland and 12 weeks in Norway).

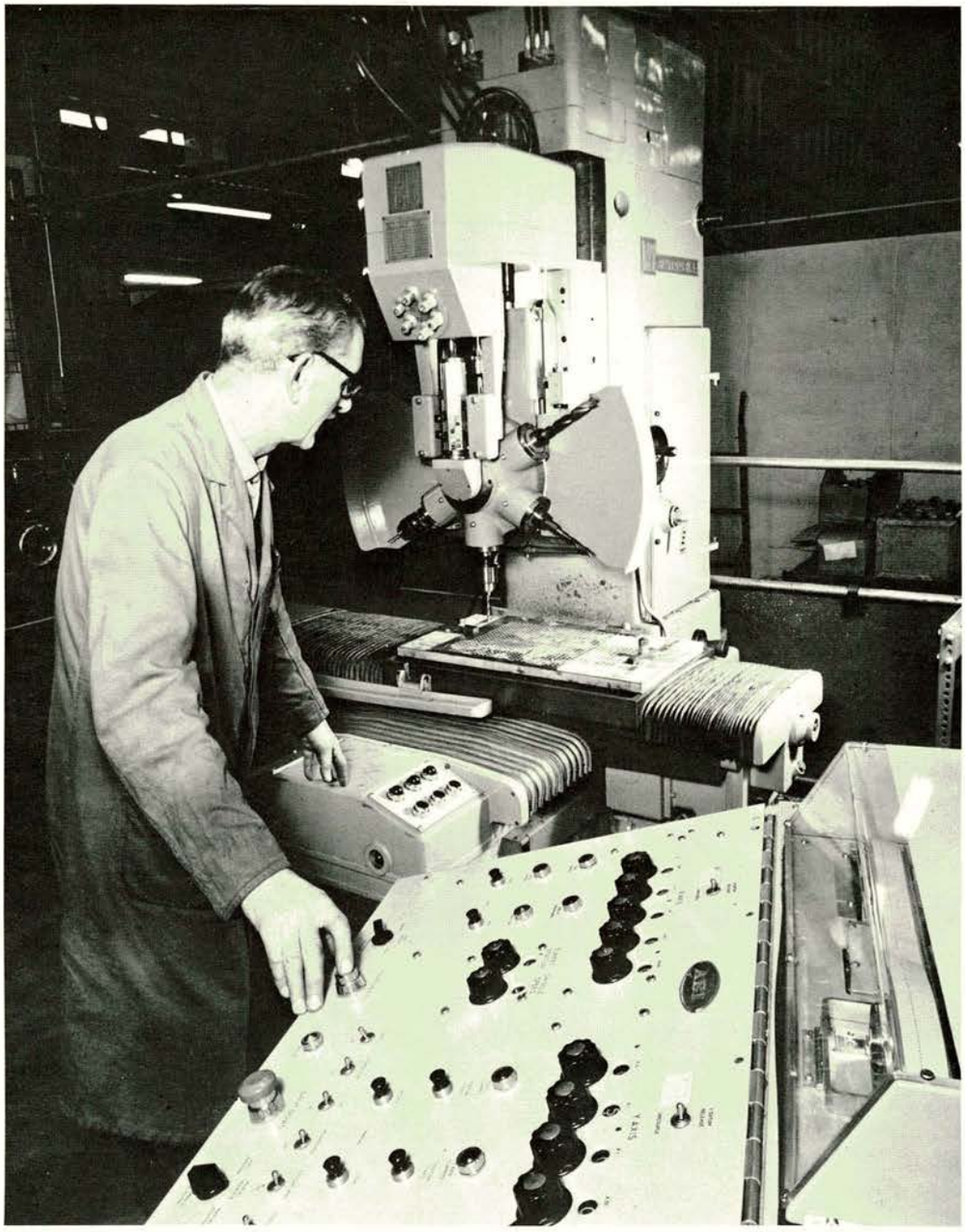
Information about the utilisation of subsidies by employers reveal that they tend to concentrate in certain kinds of industries. In France, Germany, Ireland and the United Kingdom, most jobs created have been in the labour-intensive industries most affected by the recession: clothing, textiles, footwear, construction, metalworking, wholesale and retail trade, hotels and restaurants.

The terms on which subsidies are granted do not on the whole seem to contain elements designed to encourage a better redeployment of manpower, e.g. varied rates favouring firms or industries that will be essential for the expansion. The French exemption from social security charges for example applies to enterprises of all sizes, but it appears that many of the jobs created are in small and medium-sized enterprises.

• *Direct job creation in the public sector*

Relatively few Member countries create jobs in the public sector but certain of them have well developed programmes of this kind — Denmark, Finland, Luxembourg, the Netherlands, Norway and the United States.

Although not directed to any particular age group, they have in fact tended to



"To a great extent young people are the ones who have suffered from rationalisation and from changes in job functions in industry."

Arvo AALTO, Minister of Labour, Finland

benefit young people more than other members of the labour force. It is estimated by the Danish authorities that in 1976 it was young people under 24 who benefited from about 55 per cent of the working hours created by public works programmes while women took up only about 17 per cent. In the United States, some 40 per cent of participants in public sector employment programmes under the CETA appear to be under 25. Sweden reports that more than half the people employed on relief work in the public sector are women or young people.

Again in the United States, about three-fourths of all current expenditures for employment and training are directed to the young, with the Summer Employment Program for Young People reaching the largest number: in 1977, a million federally subsidised jobs were provided through this programme to disadvantaged youngsters aged 14 to 21 in state and local government and in private non-profit bodies. There have been recent improvements in the programme: work initiation may now be coupled with some theory and theoretical and vocational training.

Some countries however have introduced special programmes directly intended to create employment for young people in the public sector or to give them priority there. In Finland, office work is created at various levels of government for unemployed young people with an academic or technical degree up to a maximum of 12 months; a similar measure in the Netherlands applies to any unemployed person under 22 years of age. The French Government decided in 1977 to create 20,000 extra jobs in the administration (notably in the Justice Ministry and the Post Office) with priority given to young people. In Norway, the government pays back up to half the cost of jobs created by municipal authorities and the full cost of jobs in state agencies for young people who have been unemployed for four weeks or who have completed a period of training or counselling. In Sweden, public works generally designed for young people are subsidised at a rate of 75 per cent of the wage costs if provided by municipalities and 100 per cent by the central government.

In recent years some Swedish cities have experimented with employing people temporarily while permanent civil servants take training. This approach was subsequently extended to all local government. A similar measure in Turkey applies to the private sector.

Member countries have also devised schemes to ensure that public employment can be created quickly and discontinued when no longer required. Thus, for example, in the United States, federal funds are made available under the CETA to state and city governments when the rate of unemployment in a given area is 6.5 per cent or more for three consecutive months. Automatic schemes of this kind have much to recommend them, especially because they do not require a specific decision and because they ensure that the programme ends when the employment situation improves. They have been found however to create more jobs for boys than for girls, taking account of their respective unemployment rates and are therefore being complemented by selective measures in the United States.

Certain countries are considering creation of permanent employment opportunities through long-term expansion of public services. Although education may not continue to grow as rapidly as in the past, new social orientations have come to the fore, e.g. extended health services (in Sweden, for example) and welfare services.

• *Employment creation by local communities*

A few Member countries have in recent years introduced special programmes which create employment through the provision of community services. This is done mainly by providing grants to non-governmental organisations, community institutions or groups of private persons for non-profit projects. Such ventures provide jobs which require a sense of initiative and so-

cial responsibility; environmental protection, for example, aid to elderly or handicapped people, construction and supervision of playgrounds. They have revealed the existence of many social needs at present unsatisfied by the public services. In practice, they provide work mainly for young people.

The Canadian Government, under the year-round Canada Works Programme (which replaces the former seasonal Local Initiatives Programme) finances projects, lasting up to 52 weeks, chosen for their potential effect in reducing cyclical, seasonal, regional or local unemployment. The programme aims to utilise the management resources of local organisations or project sponsors. It is expected that about 40 per cent of the clientele will be young people. In France, an experimental programme was begun in 1977 under which the employment subsidies represent 50 per cent of the minimum wage plus social security charges. In Spain, under a comparable programme to finance employment for up to four months, priority is given to the long-term unemployed and to provinces where unemployment is high. In Ireland, the Industrial Training Authority runs a programme specifically for unemployed young people including redundant apprentices, while in the United Kingdom, the Manpower Services Commission introduced a job creation programme in 1975 which has been rapidly expanded: it is intended to provide temporary work for up to 75,000 workers, mainly young people. In the United States, the Young Adult Conservation Corps and the Youth Community Conservation and Improvement Program aim to create jobs in environmental protection and restoration, urban rehabilitation and energy conservation for about 80,000 unemployed young people who have an immediate need for paid work. A second aim is to improve the employability of these young people, imparting skills through supervision by experienced workers.

"The high level of unemployment among girls can probably be attributed to the sterotyped views which persist concerning appropriate and inappropriate occupations for girls and boys. One of the effects of sex role prejudices is that girls have a narrower occupational range to choose from. Consequently they encounter difficulties in spite of good educational or training qualifications."

Per AHLMARK, Swedish Minister of Labour

In Sweden temporary employment is used to combat prejudice about sex roles—for example that care of children and old people is a woman's job. **Below:** *making and repairing toys in a nursery at Tyresö, near Stockholm.*

Experience shows that new programmes of this kind have a role to play — especially in countries which have no tradition of voluntary service—in solving certain employment problems, those which cannot be handled even with special assistance, through normal operation of the market in the private sector or traditional public employment. The Canadian authorities estimate that the now supplanted Local Initiatives Programme generated, directly and indirectly, a net addition to GNP; nor did it divert manpower from the private sector because rates of pay, job security and working conditions were not competitive.

The main weakness in programmes of this type is that the work done by the participants is not necessarily typical and so the fundamental long-term solution to the problem of youth unemployment may merely be postponed. Accordingly, some countries are considering how to prevent such programmes from becoming merely an alternative to income support, by introducing a period of initiation to more normal working conditions for example.

Facilitating the Transition to Working Life

• *Preparation for working life during education*

Several OECD governments have recognised the urgent need to improve young people's preparation for working life while they are still at school. They are beginning to adapt their policies to this end in several

"A number of very real needs are not being satisfied—in the fields of energy, the environment, the recycling of resources and urban renewal. But filling these needs would be of value to the community as a whole, could enhance living standards, employ large numbers of people, constitute a positive factor for the balance of payments, motivate young people and cover a very wide range of occupational skills. To achieve good results we must turn to non-traditional programmes and establish new relationships between the public and the private sector."

Svend AUKEN, Danish Minister of Labour

ways: by improving basic education; by providing specific information about industrial life; by enabling teachers to acquire more direct work experience in other sectors of the economy and opening up the teaching profession to people from other occupations; by enabling more pupils to enter the second cycle of secondary education on a full or part-time basis; by reducing the pedagogical and social distinctions between general and vocational education; by providing pupils in compulsory education with at least a minimum of basic skills for working life; by extending modular and multi-purpose curricula so as to enable pupils to continue their studies in line with their interests and job possibilities and to maintain the widest range of options for as long as possible; by introducing methods of rating and degree-giving that more directly specify the content of the education students have received and that give credit for both paid and unpaid employment; by extending and improving opportunities for pupils in school to obtain first-hand experience of work.

Many of these innovations are of recent origin and are therefore difficult to assess on the basis of experience. Moreover, because of the time required to get them in motion, few of the school-leavers entering the labour market in the next few years are likely to benefit. Such measures could however be introduced selectively—highest priority being given of course to those which seem most promising—for school-leavers of 1979. In the longer run, reforms involving recurrent education might help to strike a more effective balance between the social demand for education and employment opportunities.

• *Training by firms*

Since 1973 private firms have been led to reduce investments in training because of the lack of available funds and the large number of job seekers. As a result governments have taken active steps to promote this type of training. Canada, Ireland, New Zealand, Sweden and the United Kingdom have adopted multi-purpose programmes designed to alleviate the shortage of skilled personnel, to support industrial development strategies, to find jobs for the unemployed and induce employers to create or improve their own training schemes. The available data reveal that a relatively large proportion of the beneficiaries are young people.

During the last few years, however, several countries have taken special measures for the young. One course of action aims at preventing a decrease in the number of apprentices—and hence of skilled manpower—which could come about with the decline of the manufacturing sector and of small and medium-sized firms (Australia, Germany, Finland, France, Ireland, the Netherlands, Switzerland and the United Kingdom). Regulations which control the financing by firms of various kinds of introductory training are being modified (for example, in Australia, Canada and Finland). In France incentives have been given since 1975: when an enterprise hires an unemployed person of between 16 and 25 for 120 to 500 hours of training, the subsidy amounts to 30 per cent of the minimum wage for the employment itself during the first six months and 100 per cent for the *training*. (If the training lasts for 500 to 1200 hours, the subsidy is 30 per cent for the first three months' employment and 100 per cent during training). The scheme is financed by a special tax on the firm. In addition, the employer can be exempted from social security contributions. In Sweden there are plans to "rent" available training capacity from enterprises to compensate for the lack of room in public centres.

In Sweden, the subsidy to enterprises which give their workers training rather than discharging them, was 8 kronor an hour up to 160 hours and 12 kronor an hour from 160 to 960 hours. To avoid a sharp increase in layoffs, the subsidy was raised in the first half of 1977 to 25 kronor an hour for the first 160 hours of training and 15 kronor an hour thereafter up to 800 hours.

But other approaches besides financial incentives are also being tried. Firms are being given technical assistance in improving their training; in Canada, for example (educational counselling is provided by Provincial authorities), Ireland, New Zealand and the United Kingdom. Another approach, apparently unique at present, is the Belgian Act of 30th March 1976 under which firms employing at least 100 workers are required to have, as one per cent of their workforce, young trainees under 30 who have not yet been employed; the firms

receive no government financial help. Smaller enterprises may engage trainees and for them a subsidy is paid at the end of the training period. Several countries, including Australia, Norway and the Netherlands, have recently increased the amount of rapid training for semi-skilled jobs, as a means of helping to prevent layoffs and absorbing some of the young unemployed having few skills. In-plant training may be regarded as a more efficient use of public finance than unemployment compensation or job creation without training. In some countries (e.g. Sweden), training is being given to workers who would otherwise be laid off in the basics of working life including workers' participation and industrial safety.

"Fundamental changes in behaviour by comparison with the attitudes of earlier generations are becoming increasingly apparent. For the youth of today, work is no longer an end in itself. Work content and pay are not the only considerations. The environment of the firm or office, the pace of work, free time, the social status of the job are equally important. The hierarchical and social structure into which the work process fits is now an issue."

Christian BEULLAC, French Minister of Labour

"In most fields young people leaving school have to compete with older workers who already have experience of employment, and many find it hard to compete successfully. One difficulty is the attitude of some employers who tend to regard young people who have just left school as vocationally ill-prepared, more lacking in basic abilities than their elders, and less reliable."

Albert BOOTH, Secretary of State for Employment, United kingdom

The main weakness of the system is the result of uncertainty about the future pattern of economic growth: little information is available to guide officials in the orientation of training programmes by occupation and skill. During most post-war recessions, contracyclical training policies have been directed towards preparing the underemployed for the economic upturn.

• *Formal training*

Formal training is now more vital to young people because of their high unemployment levels and the inability of the private sector to provide adequate training for the economy as a whole. By helping to minimise or avoid future shortages of skills, training can also help to prevent cost inflation. However, even though most OECD countries have flexible and well-tried arrangements, public agencies are experiencing severe problems in planning just how much training there should be and for what occupations since the need for major economic changes in OECD countries is evident.

Several countries use formal training as an important contracyclical instrument: by absorbing some of the unemployed, it takes them out of the labour force and also improves their long-term employment prospects. The main difficulty encountered is to decide how much can be done, for whom and in what skills.

• *Counselling and placement*

Despite innovations already made in counselling of several countries, it is essential that this service should be reviewed, in order to redefine its role in a period of prolonged under-utilisation of manpower, economic uncertainty and changing attitudes towards work.

The evidence seems to indicate that most young people use the public employment service to help them find an immediate job, to be placed directly or given information on job vacancies. But the growing range of possibilities being devised—for education, training, paid work experience, etc.—places additional responsibility on those whose job it is to inform young people about these opportunities and to help them use periods of unemployment constructively.

In addition to counselling, several OECD countries have reinforced their placement

services for young people, mainly by improving information on the number of job vacancies; many governments also pay some part or all of the cost of travel to another region for an interview with a prospective employer.

• *Measures to help the disadvantaged enter working life*

One of the main innovations in Member countries during the last few years has been the development of measures to help young people who experience special difficulties entering working life. This may be because they have few formal qualifications or none at all: many of them lack the basic skills needed for working life—reading, writing, counting or the ability to communicate. Many do not know what work is or how to search for a job and a number have personal problems such as lack of confidence and sometimes drink, drugs or delinquency.

Some governments aim at providing these young people with a practical introduction to the demands, opportunities and satisfactions of working life through short periods of paid work experience. Thus the Young Canada Works Programme section of the Canada Works Programme tries not only to reduce summer unemployment but also to help young people obtain practical experience and a clearer idea of possible careers. In winter, the government pays a 50 per cent subsidy to firms willing to give 9 weeks' job experience to hard-to-place labour force entrants while the Australian Government aims to improve employability with a subsidy which is larger, and generally for a longer period, than is normal for in-plant training. In Ireland, accelerated training courses in basic skills and industrial discipline and practice, originally intended for adults, have been extended to school-leavers. Germany gives subsidies to employers to hire hard-to-place workers for up to two years, and these have been raised from 60 to 80 per cent of the relevant wages, the aim being to give the employee time to settle down to normal work. In New Zealand, the Work Adjustment Scheme gives people with poor work histories the opportunity to acquire work habits in simulated work situation over two to three months. The majority of participants continue to be young people even though the scheme, which was formerly confined to them, is now open to all workers. Trainees receive unemployment and rehabilitation benefits, as well as a production bonus. In Norway, unemployed young people under 20 can be placed in a private firm for six months and receive a study allowance as well.

Early experience with such schemes has shown that they are a relatively simple way to meet a need when a young person's employment problems stem primarily from his ignorance about working life. Participants usually receive a wage or an allowance which is somewhere between the wage rate for normal work and the rate of unemployment benefit.

"Because second generation immigrants have a hesitant knowledge of the language used in their host countries and because the latter are not making enough efforts to provide them with education and vocational training in time, these young people are handicapped when preparing for working life. As a result, their unemployment rate is much higher than that for young nationals."

Svetozar PEPOVSKI, Chairman of the Federal Committee on Labour and Employment, Yugoslavia

Improving Access to the Labour Market and the Distribution of Employment Opportunities

• *Wages and income support*

There is a widespread view that one cause of youth unemployment is the fact that wage rates are relatively high for new entrants as compared with those for older workers. Many employers cannot or will not pay such rates to young people whose contribution to production is low or even negative to begin with. Moreover, the level of current wages means that the opportunity cost of training is high, and this discourages many young people from continuing in school or taking training.

It is unlikely, however, that a relative reduction in wage rates for young people, even if achieved through an increase in the rates paid to other groups, would receive general support because of the obvious social and labour market implications. It is doubtful moreover whether this type of action can directly create jobs.

In the long run, the aim of government policy is to give young people the prospect of finally being able to earn normal rates of pay in regular employment, and this can be achieved through a coherent and judicious use of all available measures—placement and counselling, job creation and training programmes, possibly reinforced by a system of incentives. In most countries, it is a policy principle that wages should be higher than training allowances and that these in turn should be greater than unemployment benefits. Yet the complexity and lack of coordination of rates may distort this incentive effect.

A shift seems to be taking place in public expenditure from unemployment compensation to training and job creation. Budgetary constraints, coupled with the need for more positive policies as the current economic situation improves, suggest that this shift of resources might be accelerated if expenditures on employment compensation, especially for young people with no skills or work experience, were directly linked to training or work introduction. A start has been made in this direction in some countries.

• *Work-sharing*

In recent years there has been a marked tendency in several countries for firms to maintain the contractual relationship with their employees even when the latter are underemployed. Estimates by OECD's Secretariat of deviations from trend of measured output per man-hour suggest that, had previous relationships between trends in output and employment prevailed during the last recession, the rate of unemployment would have been significantly higher than it actually was (Table 1).

Several factors explain this change: the unilateral decision of some firms to retain their personnel in anticipation of recovery, and also collective agreements and other innovations which provide benefits for partial unemployment (e.g. for reduced hours or temporary non-working periods) and thereby help to reduce the number of

1. GDP PER MAN-HOUR

(1975 as per cent of deviation from trend)

Canada	— 5.7
France	— 4.0
Germany	— 1.9
Italy	— 10.3
Japan	— 8.7
United Kingdom	— 2.7
United States	— 4.5

wholly unemployed people, keep the workforce of an enterprise with its skills intact, and reduce the costs of layoff, new hiring and training. Most countries now provide benefits for persons working less than a standard number of hours each week. Canada for example plans to experiment in 1978 with pilot projects under the unemployment insurance programme to provide partial compensation for lost earnings when employers and workers agree to share available work as an alternative to layoffs.

• *Measures affecting the size of the labour force*

Training is the most important device for taking large numbers of young people temporarily off the labour market. Other measures, more limited in scope, nonetheless have a significant effect.

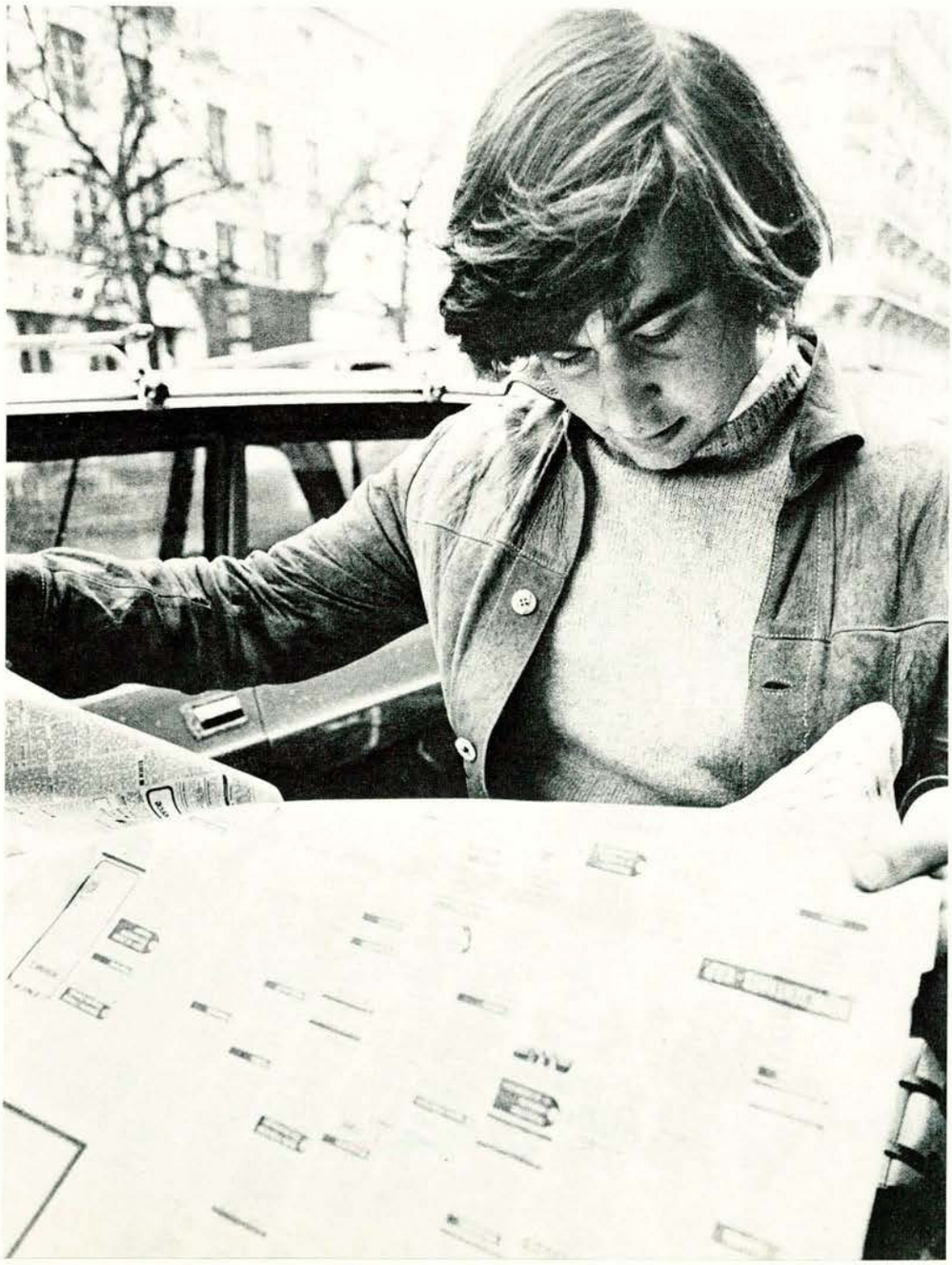
Extended education. One approach has been to increase the number of short-cycle higher educational institutions (Canada and France). Several countries provide financial assistance to help students complete their secondary schooling when they would otherwise be obliged to enter the labour force (Germany, Norway and Spain). In Germany, part-time education up to the age of 18 is obligatory for those who leave school at the end of their compulsory full-time schooling (at 15 or more). In Sweden, the education and manpower authorities have recently begun systematically to follow for two years the progress of pupils leaving ninth grade and to advise them on appropriate choices. Canada introduced a job exploration programme in 1976 to help potential "drop-outs" obtain up to nine weeks' work so that they can assess the consequences of such a decision.

Paid educational leave. Paid educational leave is a growing practice. In Germany, the Labour Promotion Act of 1969 gives employees the right to pursue further education with substantial compensation for expenses and loss of pay. Under the 1971 French Act on recurrent training, up to 2 per cent of a firm's labour force may be on training leave at any one time. A Belgian law of 1973 give full-time workers under 40 years of age the right to be absent from work for a stated number of hours without any reduction in pay. The 1974 collective agreement in Italy entitles employees to 150 hours of paid educational leave over a period of three years. In Japan, the new Employment Insurance Act offers incentive grants to small firms to cover paid leave for job-related training. In Sweden, a law in force since 1975 gives a "general right to education leave" together with an increase in allowances for this purpose and ensures workers of greater opportunities to follow recurrent education without risking loss of their job. Australian experience suggests that special incentives are needed if employees are to use such rights to educational leave during periods of reduced activity.

Although these provisions are not directly linked to the employment of young people, the fact that older workers are on paid educational leave may indirectly open up some job opportunities for the former. In addition, some countries give young people themselves the opportunity to leave the labour force for further general or vocational education. More use of such opportunities by young people appears to hinge on two conditions: solving the problem of how to finance such leaves of absence and how to make secondary education more flexible so that a new balance can be found

"We know that many young people do not contact the employment service. Some do not know that it exists; others don't know how it operates and some don't think they can receive any help there."

Leif AUNE, Minister of Labour, Norway, Vice-Chairman of the Conference



between general and vocational education permitting young people to exercise a wide range of choice in both further education and employment.

Flexible retirement. Arrangements to help older workers choose their retirement time have been introduced on a relatively small scale in recent years (Austria, Belgium, Finland, France, Norway, Spain and Sweden). Indirectly, they may create a limited number of openings for younger workers if other job-creation measures are developed and vigourously applied.

Recently, however, four countries have adopted additional incentives for older workers to retire early which are tied to new employment opportunities for young workers. In Belgium (Act of 30th March 1976), men of 60 or more and women of 55 who elect to retire and not take another job receive unemployment compensation plus a special allowance and must be replaced within a fixed time by an unemployed worker under 30 who in turn must be em-

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CHANGING ATTITUDES TO EDUCA

by Tørsten Husén Professor,

ployed for at least six months. In France, the possibility of retiring early, previously limited to persons working under particularly difficult conditions (e.g. blast furnaces or assembly lines), has been extended: since January 1977, workers aged 60 or more can retire early with 70 per cent of their previous wage, the object being to create employment opportunities for some 100,000 young people. In the Netherlands, early retirement is confined to building workers and teachers. In 1977, a temporary measure for six months, introduced in the United Kingdom, was limited to employers in their last year of work in localities designated officially as assisted areas: under this scheme a person who retires and agrees not to take another job may draw a tax-free allowance of £23 a week while the employer must take on a person registered as unemployed—though not necessarily to fill the same job. So far, it appears that relatively few jobs have been created for young workers in this way.

t-oriented society

TION AND WORK AMONG YOUTH

University of Stockholm (1)

Young peoples' changing attitudes to education and work are both a cause and a consequence of the "malaise" which pervades the educational systems of the highly industrialised countries. After increasing twice as fast as GNP during the 1960s, expenditure on education has declined for demographic reasons. The economic recession has confirmed or aggravated an already familiar phenomenon: more graduates than jobs. Moreover, the role of education in economic and social mobility has not turned out to be what the proponents of equal opportunity anticipated.

In a New Situation...

As the elimination of economic and geographic obstacles and the development of mass education enhanced opportunities for further education, there occurred a *revolution of rising expectations* among young people in the less privileged classes: formal equality of access to education was expected to lead to equality of life chances. It is easy to imagine the frustration felt, particularly by these students, on discovering that their degree leads only to unemployment or, at best, to poorly paid jobs previously held by people with less education.

At the same time, the "status-distributive" function of the educational system has been reinforced. With an extension of compulsory basic education, the labour market has tended to delegate the selection function to schools and universities, which thus operate essentially as "filters" or credential-awarding devices for the employment system with job-seekers rated and lined up in terms of their formal qualifications.

While Japan is perhaps the most striking example of a modern industrial society where there is an almost perfect correlation between formal qualifications and the attractiveness and social status of jobs in the civil service, business and industry, a high correlation can be observed everywhere between the degree of job prestige and competitive selectivity. Everywhere, too, each step in the formal system of education tends increasingly to be perceived as a preparation for the next.

An obsessive concern with grades, examinations and diplomas tends to distort basic educational values and to prevent the educational process from functioning adequately. The overemphasis on memorisation leads to a tendency to neglect less tangible objectives such as initiative, independent study, the ability to work together and to take responsibility. Curriculum content becomes secondary to diplomas and finally loses all importance compared to the ritual of exams. The specific, practical training required to exercise the profession to which schooling is supposed to lead, is neglected.

Greater competition leads to a dichotomy in prestige and employment opportunities between those who have successfully completed particular types of training or levels of study and "the others": universities or faculties find that by raising their standards, they can enhance their reputation and increase applications. Business schools are a case in point in some countries: students with excellent marks tend to apply for admission so as not to "spoil their chances", even if it means wasting whatever qualifications they may already have obtained. Whether the study and the career it leads to is really in line with the interests of the student is often a secondary matter.

Even those who are quite negative about the schooling they are receiving are ready to embark on long courses of study. They are perfectly aware of the fact that the more their formal education conforms to conventional criteria, the better their position, not only vis-à-vis candidates for entry to the next level of education but also among applicants for employment — and subsequently for social advancement. They are also aware that in spite of much recent talk of "over-education" and unemployment of college graduates, young people having a degree are three to four times less likely to find themselves without jobs than junior secondary school leavers or dropouts. This is why motivation tends to increase as the student grows older, despite the increasingly negative attitude towards formal study on the part of young people.

Another serious problem is the "new proletariat" — those who, often from the start, lose out in the academic race: backward readers and those who drop out before the end of compulsory schooling, most of whom are from underprivileged homes. Early leavers with low qualifications — or none at all — are extremely negative in their attitudes towards both school and work. It is this group from which those condemned to menial work are eventually drawn and which gives rise to socio-pathological phenomena such as crime and drug abuse.

At what stage marks should be given — and how — has become a major issue in recent years. The vigorous and even aggressive debate among the young on this question reflects a revolt against the tyranny of marks and diplomas. Some critics have called for group examinations based on fixed criteria, with the qualities required defined in advance and in absolute terms: students, instead of being rated, are merely passed or failed. The main argument for keeping a system of marking is the need for employers to have some idea of the relative level of formal qualifications of young job seekers. Within the education system itself, marks serve to select

(1) This article is based on a report prepared for the Ministerial Conference on Youth Unemployment.

1. FULL-TIME SCHOOL ENROLMENT RATES, POPULATION AGED 15-19 AND 20-24 (%)

	Males								Females								Total							
	1960		1970		1975		1980		1960		1970		1975		1980		1960		1970		1975		1980	
Germany	37	10	52	13	56	13	57	14	32	4	42	8	46	9	47	9	35	7	47	10	51	11	52	12
Australia	40	2	42	4	46	7	49	8	33	1	35	1	46	4	49	5	37	1	39	3	46	5	49	7
Austria	33	7	31	10	37	16	37	18	29	2	32	4	37	5	38	7	31	4	32	7	37	11	37	13
Canada	53	10	72	21	67	18	67	19	46	4	69	10	65	11	66	11	49	7	70	16	66	14	66	16
Spain	16	8	30	13	39	15	57	19	6	0	19	6	30	10	53	14	11	4	24	10	34	13	55	16
United States	69	17	75	27	72	24	77	26	59	7	73	13	72	19	77	21	64	12	74	20	72	22	77	24
Finland	33	12	46	20	57	25	71	29	35	9	52	15	65	20	81	23	34	10	49	18	61	23	75	26
France	31	8	41	12	49	12	52	14	34	6	50	7	54	7	58	9	32	7	45	10	51	10	55	11
Ireland	26	8	38	10	43	9	49	10	25	1	41	5	51	5	57	5	25	5	39	7	47	7	53	8
Italy	22	9	37	12	46	14	56	18	15	1	26	5	35	7	44	9	19	5	32	9	41	11	50	14
Japan	36	6	65	18	77	20	82	23	43	4	64	7	75	9	80	11	39	5	64	12	76	14	81	17
Norway	38	10	61	19	64	22	70	24	37	8	60	14	63	16	72	21	37	9	60	16	63	19	71	22
United Kingdom	18	8	35	8	44	9	47	12	15	1	33	4	44	6	47	7	17	5	34	6	44	7	47	10
Sweden	36	18	58	17	58	14	61	14	38	13	54	15	56	15	59	15	37	15	56	16	57	14	60	15

15-19 ☐ 20-24

Source: *Country replies to an OECD Questionnaire on projections of population of school age and educational enrolment.*

the best qualified when the flow of applicants exceeds the number of places in a particular line of study or during the transition to the next level of education.

In countries where the enrolment explosion is a thing of the past, the controversy over marks would not be so fierce if they were not used to maintain the keen competition. Some students oppose marks because they are perceived as an instrument by which the "ruling class" tries to train people for "slots" in the employment market, without regard to intrinsic educational values — development of the personality, a sense of co-operation and personal initiative.

Yet student opinion is highly divided on the question of marks. There are indications that a majority may prefer them to other types of individual assessment. The attitude of this majority — more silent than the activist minority — is highly pragmatic, and it is this pragmatism which is the real source of meritocracy. The educational system per se, which functions not in a vacuum but in a societal context can do nothing about it. But one may ask whether an element of meritocracy is not inherent in the social fabric of a highly industrialised society. Perhaps the drawbacks of meritocracy are the price that has to be paid to ensure economic growth and the efficient working of the social machinery.

... Changing Attitudes

In the absence of systematic evidence (and particularly of comparative evidence covering a long period) it is hard to evaluate the changes which have taken place in the attitudes of young people towards education and work. Yet student protests against marks and exams and claims for greater participation in decision-making are symptomatic of change. But even without taking into account the local eruptions which take place from time to time, it is possible to discern what might be called an on-going "silent revolution" among students inspired by values, which have led to a redefinition of work, of success and of the quality of life. These attitudes would seem to be inherent in young people growing up in highly industrialised societies since they are found — almost identically — in North America, Western Europe, Australia and even Japan. Where the educational system functions in a rather special historical and socio-cultural context. This change is characterised by a number of distinguishing views:

- Education is not intended to develop vocational skills alone but the whole personality. At every level, its aim is to prepare the individual for his future responsibilities as a committed citizen. Thus, for example, reforms introduced in France and Sweden to cope with higher enrolments, in post-compulsory education and fewer educational resources, are geared to labour market needs, and thus have been poorly received by the students, who refuse to be trained solely as a function of employers' needs. They are opposed to curricula centred on specific occupational skills because they feel they are being locked into occupations from which it will be difficult to escape. They want a better balance between theory and practice and knowledge which enables them to cope with a broad range of tasks, many of which cannot now be foreseen. In a dynamic society the individual, they feel, will need a large measure of freedom to choose his career.
- The notion of a successful career as a continuous climb from one point of selection to another, where the able and ambitious succeed and the others fail, has been rejected. The main objection to a system in which students are marked on a relative scale is that it makes student work for marks instead of trying to acquire useful and lasting skills.
- Young people who are actively resisting the spirit of competition and the cult of diplomas tend increasingly to regard their studies as something that can in various ways be combined with a career. One important symptom of the changing attitudes is the mounting number of students who no longer take their formal education as a monolithic structure. There is also a marked tendency among young people the industrialised world over to postpone the age at which they make a definitive choice of occupation.
- Much importance is attached to personal fulfilment, security and the chance to devote time to rewarding leisure activities. Young people from comfortable homes increasingly look for intrinsic satisfaction in their work, while the poorer and less educated attach more importance to its indirect benefits. But the gap between the two groups is narrowing, which suggests that the new values are no longer restricted to the privileged, articulate groups.

Young people increasingly want to hold jobs which allow them a certain margin of freedom and initiative. They want to have their say about working conditions and work organisation. They will no longer put up with the drudgery and boredom with which their elders had to make do.

Highlights from
OECD
ECONOMIC OUTLOOK
DECEMBER 1977

THE ECONOMIC OUTLOOK FOR 1978

Last June OECD Ministers agreed that, to implement their medium-term strategy for a progressive return to full employment and price stability, expansion in the OECD area taken as a whole should be somewhat faster in 1978 than in 1977. At that time, output was expected to grow by around 4 per cent in 1977. Accordingly, a 5 per cent target for 1978 seemed appropriate. It was recognised that policies might need to be adjusted to achieve this in some cases, and that the aims of individual countries should vary according to their success in restoring internal and external balance.

In the months that followed, the immediate prospects for economic expansion worsened. Real GNP for the OECD area now seems likely to have increased by only about 3 ½ per cent in 1977 (see table 1) with growth slowing down between the two halves of the year. As a result, it is now probable that efforts to achieve 5 per cent growth in 1978 would require an acceleration in the course of the year so sharp as to risk the resurgence of stronger inflationary pressures and thus run counter to the strategy. But it would still be possible, given appropriate policies, to achieve a growth path that, during 1978, accelerated sufficiciently to start reducing unemployment without provoking new inflation. A 4 ½ per cent growth for the area as a whole between the years 1977 and 1978—to which the preliminary objectives set by individual governments roughly add up—would imply this sort of acceleration without building up new inflationary forces, and thus be in line with the intentions of Ministers.

The forecasts by the Secretariat in this Economic Outlook illustrate the need for further action, in addition to the expansionary measures already taken by some countries, in order to achieve this overall objective. Without such action, growth might only be about 3 ½ per cent and, as in 1977, weaken as the year wore on. Moreover, the international payments pattern implied by the forecasts could be difficult to sustain for long. In some cases, governments have already indicated their intention to take some such further action, but have not yet specified its timing and size. It is important that policy changes to boost demand in certain countries should be reasonably prompt so as to produce a better outcome than at present forecast. It is also important that if exchange rates change significantly, such changes should be accompanied by further domestic action—expansionary demand management in the appreciating countries, and action to contain inflation where exchange rates depreciate.

1. SUMMARY OF OUTPUT AND DEMAND FORECASTS

Per cent changes, annual rates

	1974 to 1975	*1975 to 1976*	*1976 to 1977*	*1977 to 1978*	*1977I to 1977II*	*1977II to 1978I*	*1978I to 1978II*
	Real GNP						
Total OECD	— ¾	5¼	3½	3½	3¼	4	3
of which:							
United States	—1¼	6	4¾	4¼	4½	4½	3
Japan	2½	6¼	6	5	5½	5½	3¼
Germany	—2½	5¾	2¾	3¼	1½	4	3
Total OECD Europe	—1½	4¼	2	2½	1½	3	2¾
	Final domestic demand						
Major 7	¼	4¼	3¾	3¾	3¾	4	2¾
of which:							
United States	—1½	5	5	4	4½	4½	2½
Japan	3	4½	4½	5	5¾	5½	3½
Germany	1¼	3¾	2¾	3½	3	3¾	3

2. UNEMPLOYMENT RATES/ ESTIMATES AND FORECASTS

Per cent of total labour force, seasonally adjusted

	1977	*1978*	*1977II*	*1978I*	*1978II*
Total OECD[a]	5½	5½	5½	5½	5¾
of which:					
United States	7	6½	7	6½	6¾
Japan	2	2¼	2	2	2¼
Germany	4¾	5¼	4¾	5	5¼
Total OECD Europe[b]	5¼	6	5½	5¾	6

a. Representing over 90 per cent of the OECD labour force. A rate of 5 per cent represents approximately 15 million unemployed excluding Portugal and Turkey; including these two countries the number unemployed is about 17 million.

b. Excluding Portugal and Turkey.

The Present Situation and Short-Term Outlook

The pick-up in activity in late 1976 and early 1977 was short-lived. Total OECD growth weakened markedly in the second quarter of 1977 and has since remained sluggish. Industrial production has broadly stagnated since April. In the United States there has been some slowing down, and in Japan industrial output is flat; in Europe, it fell sharply in the second quarter and recent indicators show no significant improvement. There has been a generalised slowdown in consumer spending, only partly reversed in recent months, and this is the main reason why output growth in

1977 has been lower than forecast in the last Economic Outlook (see OECD Observer No. 87 July 1977). Trends in the other components of final domestic demand, particularly business fixed investment, have also been hesitant. Total unemployment in the area is now about 16.3 million, some half a million higher than at the trough of the 1975 recession, and the equivalent of about 5.4 per cent of the civilian labour force (see table 2). In Europe, unlike the United States, unemployment has in fact been rising constantly, from 4.7 million at the beginning of 1975 to over 7 million today. In many countries the weakness of the labour market has led to an actual fall in employment and a rise in the under-utilisation of employees.

Inflation, as measured by consumer prices (see table 3), fell to about a 6 per cent annual rate in the four months to October, markedly better than the 11 per cent registered earlier in the year, helped by the fall of commodity prices in response to weak final demand and good harvests. Food prices—partly for seasonal reasons—have been the most important factor contributing to the better performance in most countries. Nominal wage increases seem also to have decelerated, but to a lesser extent than prices, and unit wage costs have not shown the same deceleration because of the slowdown of production.

World trade growth became very modest in the first half of 1977, particularly on the OECD import side, and has not markedly picked up since. The OECD's combined deficit on current account (see table 4) may be currently running at an annual rate of around $30 billion, compared with nearer $40 billion in the second half of 1976. The most striking developments have been the emergence of a substantial deficit in the United States, a tripling of the Japanese surplus, but considerable improvements in the current accounts of France, Italy and the United Kingdom. The surpluses of Germany and Switzerland have persisted, and the shrinkage in the Netherlands surplus may largely be temporary. The position of the smaller deficit countries, taken as a group, has if anything become more difficult although some of the deficits have been reduced.

The Secretariat forecasts, on the basis of policies so far spelled out, show total OECD growth accelerating slightly in the first half of 1978 (see table 1). But a modest strengthening of private consumption is likely to be accompanied by a weaker trend in other types of final domestic demand taken as a whole, and an important source of such buoyancy as the forecasts contain lies in inventory changes. A deceleration in final demand and real GNP to an annual rate of about 3 per cent would be in prospect for the second half of 1978 in the absence of new government measures, with growth in Europe even slower. A weakening of the present fiscal support to demand would be one important factor likely to contribute to the slowdown. But with only modest rises in real incomes, all components of final demand would probably be sluggish.

This would leave OECD unemployment at the end of 1978 even higher than now, amounting perhaps to some 17 million, or over 5 1/2 per cent of the labour force. For Europe the rate could rise to 6 per cent.

Weak output trends might not bring much further benefit in the shape of lower inflation. Between 1977 and 1978 the price rise could fall by about 1 percentage point to around 7 per cent on average, but with little further improvement after the second half of 1977. A major difficulty seems to be the stickiness of nominal wage developments: despite deteriorating labour market conditions, little deceleration of wages is expected in most countries during 1978, particularly in the larger ones; and, with slow growth, productivity performance might be poor. The forecasts assume little or no further rebuilding of profit margins in the course of 1978.

On the basis of the sort of demand conditions depicted above,

3. SUMMARY OF PRICE FORECASTS

Per cent changes, annual rates

	Consumer prices[a]						
	1974 to 1975	*1975 to 1976*	*1976 to 1977*	*1977 to 1978*	*1977I to 1977II*	*1977II to 1978I*	*1978I to 1978II*
Total OECD	10½	8	8	7	7¼	7¼	7
of which:							
United States	8	5¼	5¾	5¾	5½	5¾	6
Japan	11	8¼	7¼	6	6¼	6	6
Germany	6	4½	3¾	4	3¾	4¾	3
Total OECD Europe	12½	10	10	8¾	8¾	8¾	8½

a. Or private consumption deflators.

4. CURRENT BALANCES

$ billion: including official transfers

	1974	*1975*	*1976*	*1977*	*1978*
Total OECD	—33	—6½	—26½	—32	—22½
of which:					
United States	—2.3	11.6	—1.4	—17½	—19½
Japan	—4.7	— 0.7	3.7	10	10
Germany	9.7	3.8	3.4	2¼	3
Netherlands	2.1	1.7	2.4	½	1¾
Switzerland	0.2	2.6	3.5	3¼	3½
OPEC	62	31	42	40	35
Non-oil developing countries	—24½	—40	—26	—22½	—33½

the volume of OECD imports might rise by less than 4 per cent in 1978. But with sales to countries outside the OECD area growing strongly, export volumes could increase by about 5 1/2 per cent. The aggregate OECD current deficit might shrink by about $10 billion to some $20 to $25 billion. Present prospects are for the surpluses of the United Kingdom and Italy to increase considerably and for the French deficit to fall further. But on present policies most of the existing major imbalances would seem likely to persist in 1978, with the United States deficit widening a little, those of many smaller countries remaining extremely large, and the surpluses of Japan and Germany being roughly unchanged or higher.

The present forecasts assume no marked deterioration in business or consumer confidence, and this might be optimistic for most countries in view of the current weakness in both domestic demand and foreign trade. Even though inventories are probably less swollen than in 1974, underlying demand trends are weak almost everywhere. In the absence of new policy action, therefore, there could be an important downside risk in the forecast. A particular source of risk is the possibility that the pattern of international payments which seems implicit in the demand and output prospects would not, in fact, prove supportable.

Policy Considerations

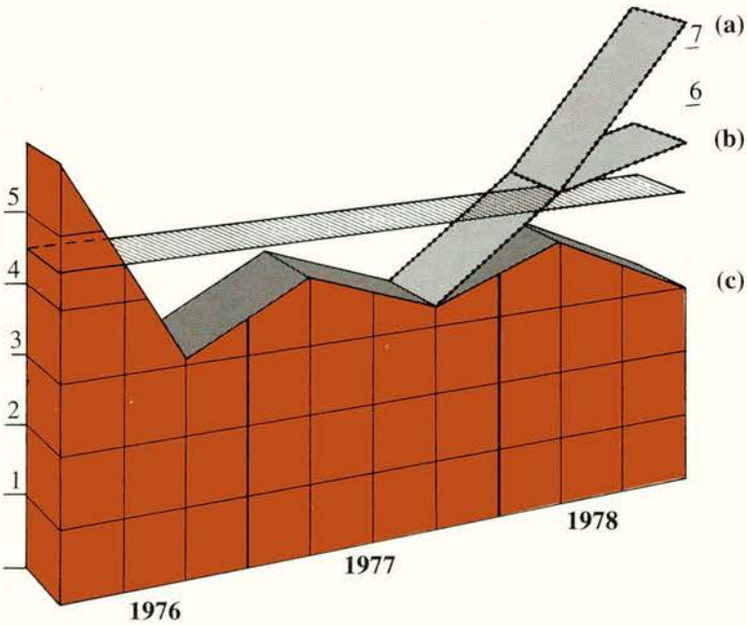
To achieve the sort of growth path that leads, during 1978, to falling unemployment will imply a considerable acceleration between the two halves of the year. As chart A illustrates, even if policies are adapted so as to push the annualised rate of growth, in the first half of 1978, up from the present forecast of 4 per cent to some 4 1/2 to 5 per cent, they will need to ensure a further acceleration to around 5 1/4 per cent in the second half if an average of around 4 1/2 per cent for the year as a whole is to be achieved. This would not be impossible if appropriate policy adjustments are

made promptly. It could be compatible with consolidation of the lower rate of inflation now prevailing. And it would mean that the unemployment trend would be reversed from around mid-1978. It would establish a reasonable growth path for the progressive achievement, thereafter, of the dual aims of the OECD Strategy. But the diagram also illustrates a source of potential danger should a more ambitious target be attempted. For example, a 5 per cent increase in real GNP in 1978 compared to 1977 could involve an acceleration in the annual growth rate in the second half of the year to over 7 per cent, and it is doubtful whether this sort of acceleration could be accomplished without sparking off a fresh round of inflationary impulses.

The need for further policy action to buoy up demand, over and above that already taken, if the gap between forecast growth and national objectives is to be bridged, seems clear enough. International payments forecasts also make clear how important it is that the timing and scope of such action should be sufficiently differentiated between countries as to achieve, progressively, a more sustainable pattern of current account balances inside the OECD. There is widespread agreement that surpluses and deficits as large as those experienced in 1977 and forecast for 1978 could not be absorbed for long, and that preservation of an open trade and payments system requires that an early start be made on the reduction of the largest outstanding imbalances.

A large number of deficit countries now feel that the balance of payments is an important constraint on their policies for economic growth, the size of their deficits on current account inhibiting a more expansionary management of demand. This is true in the case of many countries taken individually, but is much less true for the OECD area taken as a whole. It is possible for the area as a whole to have a higher rate of growth in 1978 than in 1977 without exacerbating the pattern of payments imbalances on current account—and, indeed, with some improvement in the pattern as the year progressed. But this will require, in the first instance, an important differentiation between the policies of individual countries. It will be essential that the countries facing no—or relatively small—balance-of-payments constraints should take up slack in their economies faster and somewhat earlier than most of the rest. This is not to say that these countries, simply by expanding their own domestic demand, could be expected to pull the other countries up with them, as has sometimes been suggested. But if countries with strong payments positions ensure that their domestic demand rises faster than their GNP, others will subsequently be able to afford to impart some stimulus to their own growth rates, because their payments balances will be moving in the right direction.

A. GROWTH OF REAL GNP IN THE OECD AREA
Percentage changes at annual rates over previous period

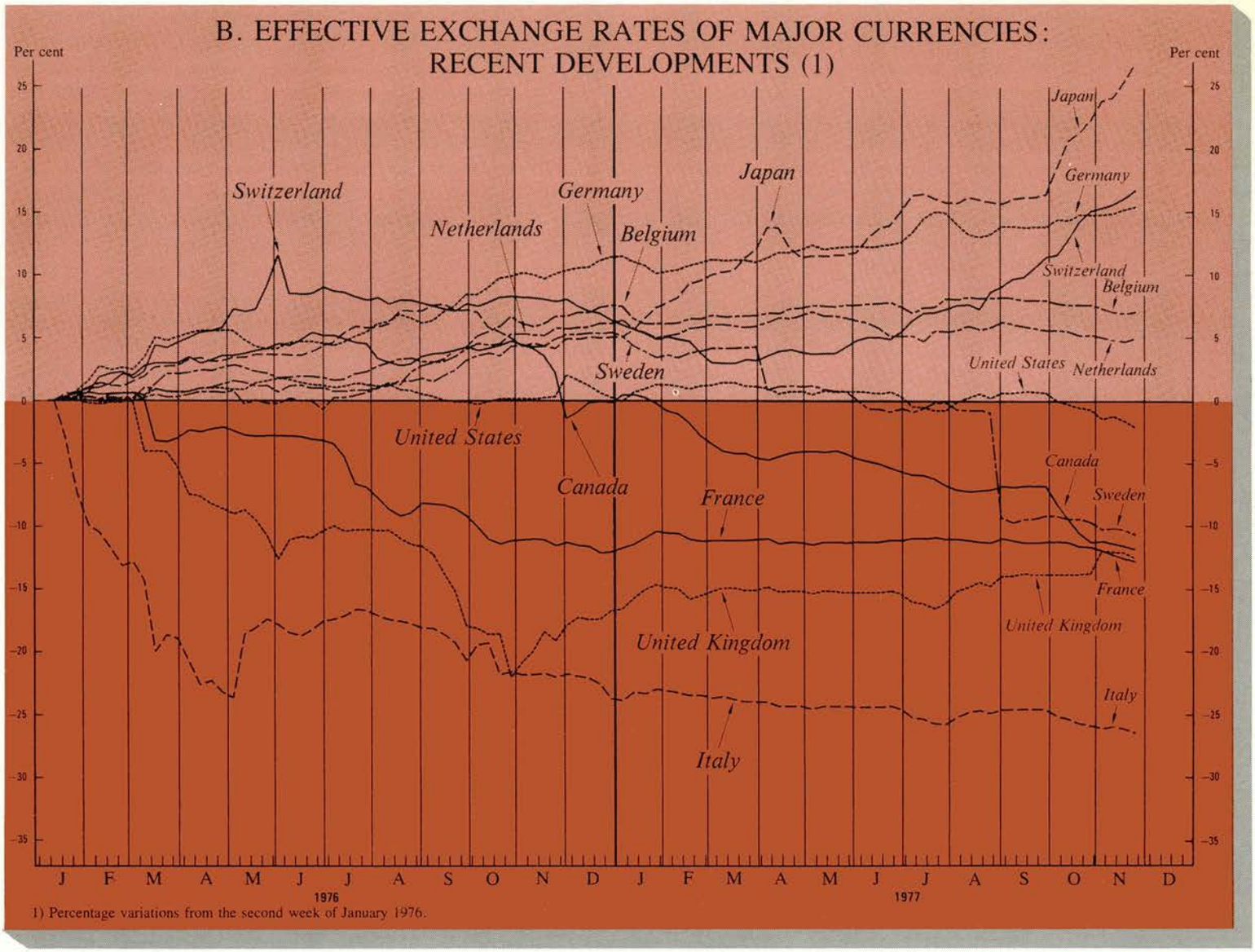


a) Illustrative growth path to obtain 5 per cent GNP growth in 1978 with 4 3/4 per cent annual rate in first half of 1978.
b) Illustrative growth path to obtain 4 1/2 per cent GNP growth in 1978 with 4 3/4 per cent annual rate in first half of 1978.
c) Actuals and Secretariat forecasts (3 1/2 per cent real GNP growth in 1978 compared with 1977).
***Note:** Shaded area represents the rate of growth of GNP required to keep the unemployment rate in the OECD area broadly constant.*

The United States has, over the last two years, taken up slack more rapidly than the average of the others, and the Administration is understood to be designing proposals to ensure that the expansion does not weaken prematurely and that unemployment continues to fall. In some countries with strong payments positions, however, the forecast growth of domestic demand is relatively modest. If the global picture is to be coherent, Germany, Japan and some smaller countries will need to absorb slack significantly faster than the rest of the OECD area, and to achieve this through stronger domestic demand. The measures that the Japanese authorities, for example, are now considering to strengthen demand at home may have an important bearing on the outlook for global recovery in 1978. Attempts by the stronger countries to rely on exports to achieve their individual growth targets would lead to a more unfavourable current external payments position elsewhere and add to deflationary forces throughout the OECD area.

In considering the sustainability of the balance-of-payments outlook, the question of the United States' current account position looms large. The effect on the position of the relatively faster recovery rate of the United States is illustrated by the area breakdown of its trade movements. Of the $40 billion negative swing in the United States trade balance between 1975 and 1977, nearly $10 billion has been with other OECD countries, about $ 15 billion has been with non-oil developing countries, and about $15 billion with OPEC countries. In the slightly longer run, the United States can probably do more than any other OECD country to reduce both its own current account deficit, and the surplus of the OPEC countries, by applying adequate and timely energy policies. In the very short run, however, reduction of the deficit will largely depend on changing the present differential between rates of recovery in the United States and other important trading countries. The importance that this should begin soon to be achieved, and by a constellation of national policies conducive to economic recovery in the OECD area as a whole, lies in the possibility that if the United States current account deficit remained very large the dollar could weaken significantly. There would be growing doubt in the exchange markets whether the present imbalances on current account were, in fact, going to be reversed, and the consequential uncertainties concerning exchange rates might well undermine confidence in many countries, with unfavourable implications for growth prospects in the area as a whole. So long as the United States deficit remains near present levels, avoidance of significant further exchange rate changes will require a very high degree of co-ordination between national monetary policies: United States interest rates have to be *relatively* high, but without raising domestic rates to levels which jeopardise reasonable continued growth in the United States and in the world as a whole.

In present circumstances the need for the economic policies of individual countries to be co-ordinated on a broad basis is particularly great. If a country with a weak external position acts alone to expand demand, it is very likely that its exchange rate will depreciate and that the effects of its action will appear more in the form of inflation and less in the form of higher output and employment than would be the case if similar action were being taken else-



1) Percentage variations from the second week of January 1976.

where. Appropriate changes in exchange rates, however, can help to ease the constraints that the present balance-of-payments pattern imposes on the recovery process. Such changes as have taken place recently, despite sharp movements in some bilateral rates, have not led to very large changes in effective rates except in the case of the Yen and the Swiss franc (see chart B). The movements in effective rates have generally gone in the direction required for balance-of-payments adjustment; and though they may not have much effect on the current account configuration for 1978 as a whole, they could help speed up the movement towards a more sustainable pattern in 1979 and beyond if they can be made to stick in "real" terms—i.e. if they result in changes in competitive positions and are not simply the reflection of different inflation rates between countries.

In the somewhat longer run, real exchange rate changes are an essential tool of adjustment; but they will only be successful if they are flanked by continuing differential demand management. This is not a prescription which condemns strong countries to overheating and weak ones to chronic recession: if the adjustment process is working properly, the growth rates of total output—and, hence, demand pressures—would not differ between countries as much as the growth of domestic demand, because revaluing countries would see their net exports decrease and devaluing countries would see theirs develop. Recent experience shows that the effect of real exchange rate changes on physical flows of trade is rather slow. During the period of adjustment, countries in current surplus can help to ease the problems of others by exporting as much capital as possible in long-term form. But in a world where the propensity to save is too high and where there is a corresponding shortage of suitable and willing borrowers, the export of long-term capital cannot be regarded as an appropriate *substitute* for current account adjustment.

Even if payments positions are progressively adjusted, the constraint on demand management constituted by inflation in a number of countries cannot be ignored. There are still countries where, if any change of policy is appropriate, it should be in the direction of greater prudence in demand management. On the other hand, there may be countries in an intermediate position where the faster growth they would be able to achieve in the wake of reasonable expansionary action by the stronger would be accompanied by some easing of the inflation constraint. The improvement of their payments positions, by its effects on their exchange rate movements, would ease their price experience; and greater confidence resulting from a combination of stronger exchange rates and slowly rising activity could lead to a restoration of conditions that had an important further beneficial impact on price performance. This combination of circumstances may be particularly beneficial where countries are seeking, by direct means, to influence decisions concerning wages and prices.

Successful pursuit of the OECD's strategy in 1978 will depend, importantly, on the manner in which monetary and fiscal intruments are used. Monetary policy has so far been relatively cautious in the present upswing. The move by a fair number of countries to a strategy which emphasises norms for the growth of monetary aggregates seems so far to have been working relatively well, with certain errors of the early 1970s avoided (1). Day-to-day im-

plementation is undoubtedly rendered difficult by the need to assess the reasons for sometimes quite marked short-term movements in the aggregates. Nevertheless, the underlying monetary relationships would seem to be sufficiently stable and predictable for this approach to be helpful. If real demand gathers momentum, slightly faster rates of monetary expansion might be justified in some countries to accommodate it without reigniting inflationary behaviour. But any attempt to use monetary expansion as the main means of stimulating demand would seem inappropriate because of its likely effect on price expectations, which would probably show up particularly clearly in commodity markets.

Some governments moved rather fast in reducing fiscal stimulus in 1976 because of understandable concern at the time to avoid too strong a boom. Following this major swing in budget positions in 1976, there was a further slight movement towards restraint in 1977. On present budget plans, there should be an expansionary impulse in 1978, but without some reinforcement this seems likely to level off after mid-year. If growth objectives for 1978 are to be achieved, a substantially larger year-to-year swing in budgetary positions seems needed in some countries. Such action would necessarily involve increased public sector deficits, but large budget deficits are justifiable in present conditions given the excess of savings over investment in the private sector and the high savings of the OPEC countries. The frequently expressed concern about the financing of large government deficits is not borne out by recent experience (2). Nor would the present level of public indebtedness and government financing requirements seem to provide reasons—on economic grounds—for not accepting temporarily an increase in the deficits. It has of course to be recognised that financial and exchange markets, and important sections of public opinion in some countries, find it difficult to accept large deficits. This means that there is an important task for certain governments to persuade opinion that, in present circumstances, action to increase deficits in the short-term is desirable and feasible. Contrary to some public comment, experience in recent years in a number of important countries demonstrates that temporarily high deficits are certainly not irreversible. And the evidence suggests that demand management through appropriate combinations of fiscal and monetary adjustment can work efficiently in either direction—restraining or increasing demand according to the broad needs of stabilisation policy, and facilitating the recovery of profits that will be necessary for any substantial revival of business investment over future years.

The Secretariat's expectation is that a number of stronger countries will make policy adjustments that provide new stimulus to the recovery in 1978, and that as a result the out-turn for the area as a whole will exceed the forecasts summarised above. The need for this to happen, in an adequately co-ordinated fashion, is clear. Unless recovery rates in line with the aims of the medium-term OECD strategy are progressively achieved, unemployment will continue to increase from its already very high level. Protectionist pressures would probably continue to rise strongly. Primary producers would be seriously hit as the recent improvement in the terms of trade wore off. Low levels of productive investment would continue and jeopardise job opportunities in the years to come. And there would be a risk that a widening net of overt or covert subsidies to help particular sectors of the population or of industry would enmesh the OECD economies. Indeed, continued very slow growth would delay the structural changes needed to adapt the economies of Member countries to higher energy prices, to changing competitive positions within the OECD area, and to the emergence of new competitors outside the area. Those difficulties which at present result from cyclical conditions would gradually get built into the structure of OECD economies. The progressive return to high employment will not, in itself, solve all such problems, particularly those associated with excessive dependence on imported oil. But it will create conditions under which they are much easier to handle.

DEVELOPMENTS IN INDIVIDUAL COUNTRIES [3]

United States

The recent strengthening in most forward-looking indicators and the expansionary fiscal measures adopted in the spring suggest that growth of final demand will accelerate somewhat over the near term from the slow pace experienced during the summer. But, in the absence of fresh policy stimulus, the latter part of 1978 could see the rate of growth falling below potential, thus risking a renewed rise in unemployment. Real GNP is forecast to decelerate to a 3 per cent annual rate in the latter half of 1978. Since GNP must grow by more than 3 3/4 per cent for unemployment to be reduced, the unemployment rate could reach a lower plateau of around 6 1/2 per cent by mid-1978 and show a small rise during the second half of 1978. However, official statements suggest that — if necessary — new policy measures will be proposed to maintain a rate of expansion consistent with a further decline in unemployment. Action in this direction would help produce an out-turn that was rather more buoyant than that forecast — on the basis of existing policy. Prices are forecast to accelerate slightly between 1977 and 1978. The current account deficit may be around $ 19 1/2 billion in the second half of 1978 compared to $ 17 1/2 billion for the last half of 1977.

Japan

As pointed out in *Economic Outlook* and as reiterated in recent official statements, it is the intention of the Japanese authorities to take appropriate measures in order to promote a sustained expansion of the economy in line with medium-term objectives (around 6 per cent growth of real GNP) and to obtain a significant reduction of the large current account surplus. The Secretariat's forecast, based on presently announced policies rather than announced intentions, shows a relatively weak underlying trend of demand and output in 1978, with both GNP and total domestic demand increasing by around 5 per cent. As the impact of present policy measures wears off, the growth of real GNP may fall to an annual rate of only 3 1/4 per cent in the second half of 1978 compared with 5 1/2 per cent in the preceding two half years. As a result of these demand and output trends the labour market is foreseen to remain sluggish throughout the forecast period, with the unemployment rate increasing slightly. Further progress is expected to be made on the inflation front in 1978. Based on the usual technical assumption of unchanged exchange rates (from the level reached at mid-November) and assuming a further slight improvement in the terms of trade, the trade surplus may reach a record $ 18 billion in 1978, while the current surplus is forecast to remain close to that registered in 1977 (around $ 10 billion) with no significant change during the period. →

(1) The December Economic Outlook discusses some of the difficulties facing major countries in implementing target-oriented monetary policies.

(2) A special section on "Public Sector Indebtedness and Government Financing" is included in the OECD's December Economic Outlook.

(3) These forecasts are based on the exchange rates that existed in mid-November 1977 and the assumption of an unchanged policy stance.

Germany

Despite the fiscal measures recently taken or proposed, the demand outlook is still for GNP growth to fall well short of the rate required (4 per cent or more) to reduce labour market slack. The Secretariat foresees real GNP slowing to a 3 per cent annual rate in the second half of 1978 entailing a fall in employment; a rise in the seasonally-adjusted unemployment rate to above 5 per cent in the course of 1978 could be in prospect compared to 4 ½ per cent in the autumn of 1977. The inflation rate is forecast to remain very low. With decelerating wages, slightly improving output developments, and some decline in dependent employment expected between 1977 and 1978, the increase in average unit labour costs could fall by 1 ½ percentage points to 3 per cent. Assuming some recovery in unit profits, the GNP deflator would increase by around 4 per cent, partly because of the planned increase in standard VAT rates. Despite higher transfer payments and buoyant tourist expenditure, the current account surplus could increase again from $ 2 ¼ billion in 1977 to around $ 3 billion in 1978.

France

A number of modestly expansionary measures have been taken during the last few months, but the stance of economic policy has remained primarily aimed at stabilisation. On the basis of present policies and external prospects, the Secretariat's forecast points to GDP growth of around 3 ¼ per cent for 1978 compared to the official forecast of 4.3 per cent growth which is based on rather optimistic assumptions about foreign demand and contains important normative elements. Since a 4 ½ per cent growth rate may be required to prevent unemployment from rising, the Secretariat's output forecast suggests a rise in the unemployment rate to roughly 6 per cent during 1978 if no substantial policy changes are made. The expected weakness of demand should continue to inhibit the development of inflationary pressures. The rise in consumer prices for 1978 as a whole might be about 8 ¾ per cent (compared with 9 ½ per cent in 1977) with the rate of increase during the second half falling below 8 per cent. The trade deficit, which continued to shrink in the second part of 1977, might settle at around $ 1.6 billion in 1978. With the invisible balance improving, due essentially to the continuing favourable trend in the services account, the current external deficit in 1978 could fall moderately to around $ 2 billion.

United Kingdom

GDP is forecast to grow by about 3 per cent between 1977 and 1978 compared to 0.2 per cent for 1977. Partly, the recovery is due to the effect of stimulatory measures taken in July and October, and to the direct effects of North Sea oil. Employment may pick up after the first quarter of 1978, and given the assumption adopted about the effects of the employment-creating and training programmes, the rise in unemployment is expected to level off in the first half of next year, at a little less than 6 ½ per cent. On the basis of wage developments (elaborated in the text), and assuming that the rise in import prices remains relatively moderate, the rise in consumer prices (implicit national accounts deflator) may remain at about 8 ½ per cent (annual rate) in the first half of 1978 but accelerate to a rate of nearly 10 ½ per cent in the second half. Special factors, growing North Sea oil production and a significant improvement in the underlying position of the real trade balance have led to a sharp swing in the current balance of payments position — from a deficit of some $ 2 ¼ billion, annual rate, in the first half of 1977 to a surplus of $ 3 ½ billion in the third quarter. The current account may be running at a surplus of $ 3 billion, annual rate, in the second half of 1978.

Canada

The Canadian economy seems likely to continue to face difficult problems throughout the forecast period. The October expansionary measures may alter the time profile of demand but seem unlikely to improve overall growth performance very much during 1978. GNP is forecast to grow within the 3 ½-4 per cent range, compared with the country's average medium-term potential rate of probably around 4 ¾ per cent. Indeed, given the present degree of slack, a GNP growth of over 5 per cent may be needed to prevent unemployment from rising. The unemployment rate could exceed the 8 ½ per cent mark by the latter part of 1978 despite the measures announced in October. Indeed, there may be some danger that unemployment could go even higher. There seem to be good prospects for continued deceleration of the inflation rate, which could bring the seasonally adjusted rise in consumer prices during 1978 to around 6 per cent. The trade surplus should rise quite substantially. However, a continued deterioration in the services seems likely to limit the reduction in the current account deficit.

Italy

On the basis of the measures currently in force, monetary policy will probably continue to be moderately restrictive, but fiscal policy would cease to have a deflationary effect next year. On present policies domestic demand, after a probable decline in the second half of 1977, is likely virtually to stagnate in the course of next year, only the positive contribution expected from the external balance causing a small increase in GDP of about 1 per cent for 1978. Total employment will probably rise again slightly, but may not suffice to accommodate the increase in the labour force. Accordingly, the present level of unemployment may rise further. Despite the expected small gains in productivity, domestic prices should benefit in 1978 from the slowdown in import prices and the weak state of demand. Nevertheless, the price increase will probably still be much more rapid than the average for other Member countries with the GDP deflator rise for 1978 being around 12 ¾ per cent. The only appreciable support for higher activity seems to lie in exports. The trade balance could be close to equilibrium in 1978. There may be some further increase in net earnings from invisibles and the current balance of payments could show a surplus of the order of $ 1 ½ billion in 1978.

Other OECD Countries

Developments in the smaller countries in the first half of 1977 were less favourable than in the larger economies: demand and output were weaker, inflation rates higher and little progress was made in reducing current account deficits. Despite the consequences for output and employment, most smaller countries have had to maintain or intensify restrictive demand management in an attempt to improve the balance-of-payments and price performances. Only in the Netherlands and Ireland is policy for 1978 assumed to shift to an expansionary orientation. As a consequence of the tight policy stance, total domestic demand among the smaller countries might grow by about 1 per cent, which would be even slower than in 1977. But the increase in real GDP is forecast to accelerate to 2 per cent in 1978 as the foreign balance may contribute 1 percentage point to growth. Unemployment may rise in most smaller countries, and could total around 5 per cent of the labour force in the second half of 1978 compared to 4 ½ per cent in mid-1977. Despite weak labour markets, the rise in the GDP deflator is forecast to remain at around 10 per cent for the third year in succession. Despite a better foreign balance in volume terms in 1978, the reduction in the current account deficit of the smaller countries excluding Benelux, Switzerland and Norway may be small (around $ 2 billion). Such improvement in the deficit as does take place in 1978 should be fairly widely spread between countries.

THE DEBT PROBLEM OF DEVELOPING COUNTRIES: A Challenge to the International Community

by Edgar Kröller, Head of the Financial and Technological Policies Division of OECD's Development Cooperation Directorale

The disbursed debt of those developing countries which import oil rose from a nominal value of $90 billion at the end of 1973 to more than $170 billion at the end of 1976, while their debt service rose from $13 billion to over $25 billion (see page 26). The debt problem of these countries was a central focus of international attention during the North/South Dialogue (the CIEC) in Paris which ended last June. Meanwhile the discussions have continued in other fora, especially in the framework of UNCTAD which will meet shortly at Ministerial level. The DAC Working Party on Financial Aspects of Development Assistance has had the debt problem of developing countries under review for many years and has provided substantial inputs into the international debt discussion, especially at UNCTAD. The elements of the problem are outlined in the following article.

1. EXTERNAL DEBT AND DEBT SERVICE OF THE LARGEST DEBTORS

Country	Indebtedness		Average Annual Rate of Growth 1972-76				
	Debt end 1975	Debt service 1976	Debt service	Exports of goods and services	Total net inflow	International reserves	Real GNP
	$ billion		per cent				
1. Brazil	21.2	4.56	33.6	25.5	23.8	11.8	7.4
2. Mexico	14.3	2.72	22.9	16.8	35.1	9.1	4.6
3. Iran	5.9	1.76	14.9	50.0	9.8	74.2	15.9
4. Yugoslavia	5.5	1.39	51.9	22.7	28.5	29.4	5.9
5. Spain	4.5	1.19	31.2	16.3	23.9	1.3	4.1
6. Algeria	7.1	1.18	45.3	40.6	45.6	41.7	8.4
7. Argentina	4.0	1.16	19.2	19.1	23.6	36.4	2.0
8. Korea (Rep. of)	5.8	1.01	21.1	42.4	23.4	41.4	12.0
9. India	11.8	0.90	8.2	20.4	23.6	27.0	4.8
10. Israel	5.9	0.87	16.6	16.5	17.6	3.0	3.6
11. Chile	3.6	0.86	55.1	23.6	—2.0	32.3	—3.0
12. Greece	3.6	0.78	31.9	21.0	87.7	— 2.7	3.6
13. Indonesia	8.9	0.78	48.5	47.9	42.2	27.1	6.1
14. Egypt	5.1	0.74	20.3	34.4	151.5	25.0	3.9
15. Peru	3.1	0.55	19.9	10.9	33.3	— 9.1	5.3
16. Philippines	2.7	0.52	35.1	21.7	46.2	31.3	7.0
17. Taiwan	2.4	0.47	28.8	28.3	—0.1	11.5	6.5
18. Colombia	2.5	0.37	20.7	24.6	—1.0	37.4	6.5
19. Turkey	3.5	0.37	9.9	17.9	15.8	— 5.4	7.2
20. Pakistan	5.5	0.34	19.3	21.7	21.3	17.3	4.9
Total 20 countries	**126.9**	**22.52**	**26.3**	**27.1**	**28.7**	**19.4**	**6.1**

The developing countries have been under pressure simultaneously to accelerate their economic development and to pursue active social policies in an international economic situation which is marked by many uncertainties. It is therefore not surprising that several developing countries have over-extended their debt servicing capacity and borrowed more and on harder terms than would have been prudent—thus mortgaging their future with contractual payment obligations which some of them may be unable to meet without cutting down drastically on their development objectives.

The "debt problem" is not confined, as is often thought, to the more advanced developing countries—though it is true that the largest borrowers among them (see table 1) are those which have been able to attract hard loans of the kind most likely to give trouble. The problem also afflicts the poor—and even the poorest—countries whose debt is by no means confined to concessional official development assistance loans, although the efforts of donor countries are being directed to concentrating the flow of soft aid on these countries.

This situation provides a challenge to the international community—to seek ways and means of helping the developing countries in their debt management, to provide relief in cases which leave no other solution and, above all, to maintain a healthy international economic environment which supports the export earnings of developing countries.

Analysing the Problem

Although it is true that every additional net dollar of foreign loans adds one dollar to the recipient's external debt, this

relationship need not be the source of debt servicing problems: external debt is not only a liability but also an expression of foreign loan resources which have not yet been repaid and are therefore still being used in the development process.

In fact, the volume of debt outstanding is in itself probably the least meaningful variable in debt analysis. The nominal debt value may include both very hard and very soft loans—the grant element ranges from zero to about 90 per cent—as well as a wide variety of intermediate terms. If nevertheless one uses debt as the key variable, to get a true picture it must be discounted to its present value, i.e. that amount which, if immediately repaid, could theoretically rid the debtor country of all its future debt service obligations (or, seen from another point of view, the amount which leaves the creditor neither better nor worse off than if he had received interest and repayment on schedule) (1).

The more liberal the loan terms, the less is the present value of debt as compared to its nominal value. For example, the discounted present value of the debt of the World Bank's International Development Association, the most concessional of the international lending institutions with a grant element of 86 per cent, is only 14 per cent of its nominal value; that of the Official Development Assistance (ODA) loans of DAC countries with their 60 per cent average grant element is 40 per cent of the nominal value, while that of Euro-currency debt, which being at market terms has by definition no grant element, is the same as its nominal value.

Operationally the more relevant magnitude for debt management is the debt service which is determined by the structure and terms of the outstanding debt. However, even here an important distinction must be made between the current (interest) cost and the amortization (repayment) because, as long as amortization payments are rolled over through new borrowing, they do not constitute a net charge on the debtor's balance of payments. While borrowers, of course, repay individual loans, developing countries, both separately and as a group, are not expected to reduce their overall external debt by making net repayments for some time. On the contrary, they will continue to be net recipients of external loans which will add to their existing debt.

Whether foreign debt benefits or impoverishes the borrowing country depends essentially on the current cost of the resources and the uses to which they are put. If the foreign resources are used for investment and if the marginal current cost of borrowing is less than the marginal productivity of the investment programme (in terms of foreign exchange), the recipient stands to benefit from the external debt accumulated. For developing countries on average, the current (interest) cost of their outstanding debt is some 6 per cent which is a relatively modest charge considering that the real interest rate is much lower due to inflation. For poorer countries, the current interest cost of their debt is around 4 per cent.

Genuine debt servicing problems arise therefore only if external resources are consumed (by displacing domestic savings for example, or meeting current import needs) rather than invested, or if the recipient's investment programme yields a marginal return which is less than the marginal cost of borrowing. In theory, this means that the most expensive loan should have an interest rate no higher than the rate of return on the least productive project. In practice, however, rates of return usually cannot be measured precisely: some investments do not take the form of projects, and considerations other than cost and benefit are likely to determine decisions about borrowing and investment.

Temporary debt service problems (as distinct from the more fundamental cost and benefit considerations) may occur if an individual recipient is unable to roll over amortization payments through new borrowing. This may be due to a

THE EVOLUTION OF DEBT

The debt build-up of developing countries has significantly accelerated in recent years, notably after 1973. This picture reflects the nominal values for debt and debt service. However, if the nominal amounts are adjusted for inflation, it appears that the developing countries' debt burden actually decreased in real terms in 1972-74, followed by a rise thereafter. In practice, the erosion of the debt service burden by inflation means that the debtor country will need a smaller volume of exports, or has to forego a smaller volume of imports, to service its debt than in the absence of inflation. Inflation, however, has had the opposite effect on the real value of external reserves ("negative debt").

Debt evolution was also influenced, especially in 1976, by the fact that some of the developing countries with more dynamic economies borrowed more than was necessary to cover their current balance-of-payments deficits. The reason was that they wished to build up their reserves (which increased by $11 billion for non-oil developing countries in 1976, of which Brazil alone accounted for $2,5 billion), firstly, to improve their credit-worthiness for future access to foreign capital markets and secondly, to protect themselves against possible difficulties in obtaining adequate volumes of private bank loans in a situation where the banking community, due to high exposure and official warnings, may be unwilling substantially to extend new net lending in future years. Some countries also merely changed the structure of their external liabilities by replacing foreign-held equity by debt.

The general trend in the evolution of LDC debt and debt service until 1976 is shown in the tables below.

GENERAL TREND IN THE EVOLUTION OF LDC DEBT AND DEBT SERVICE

$ billion

	1967		1974		1975		1976	
	DD	DS	DD	DS	DD	DS	DD	DS
Total LDCs	**48**	**6.2**	**137**	**19.8**	**173**	**26.0**	**207**	**32.0**
Non-oil LDCs	42	5.8	113	15.8	144	20.8	172	25.6
of which: Poorer LDCs	11	0.8	24	1.7	28	2.1	31	2.3

DD: Disbursed Debt *DS: Debt Service*

change in the creditor's perception of the borrower's creditworthiness, to bank exposure limits, to crowding out by other borrowers, or to a shortage of loanable funds. Such a situation may also arise if large gross borrowing is required to secure modest net loan inflows, or if debt service payments are "bunched" in certain years.

The extent of roll-over problems can be measured by the share of its outstanding debt which a debtor country has to reborrow each year just to stay at the same point, i.e. to keep its debt constant. This share is determined by the maturity of the outstanding debt (2). If, for example, the debt is composed of five-year loans, the debtor country must annually reconstitute 33 per cent of its debt just to stay at the same point; for 10-year debt the share is 18.2 per cent, 12.5 per cent for 15-year debt and 9.5 per cent for 20-year debt.

Much of what is currently referred to as "debt problems" are essentially balance-of-payments difficulties which are somewhat arbitrarily associated with debt service payments since the latter constitute a contractually fixed and therefore rigid element in the balance-of-payments. To meet such difficulties, the developing countries have a whole spectrum of policy tools at their disposal, including efforts to increase exports and reduce imports, to secure additional external resources and improve their creditworthiness. Only if a country has exhausted these possibilities, do its debt service payments become the residual on which its future import capacity and growth prospects hinge. Nevertheless, it is this link which developing countries emphasize when they seek debt relief. Some of them, especially when they become the victims of events beyond their control, internal or external, may indeed face the predicament of either having to reduce their development objectives to below minimum acceptable levels or recognise their inability to service their debt on schedule.

The economic events following the oil price rise provide a good example of such a predicament. Non-oil-exporting countries had to absorb the shock of higher import prices at a time when they were deprived of adequate export earnings because of the economic recession in OECD countries. Because of the developing countries' need to maintain at least a minimun momemtum of growth and the relatively narrow scope for immediate internal adjustment, these countries were obliged to borrow heavily from external sources to balance their external accounts. As a result these developing countries are saddled with high contractual debt servicing obligations (over $100 billion for the 1978-1980 period).

Aside from the conceptual difficulties of defining a "debt problem", it is not possible to devise single or composite statistical indicators which unequivocally indicate the presence or absence of an acute or approaching debt crisis. Timely and complete data are not usually available, and non-economic phenomena, which cannot be captured by statistical data, are often of decisive importance for a country's credit-standing which, in turn, determines its ability to roll over its debt (3).

THE DEBT SITUATION BY CREDITOR SOURCE

$ billion

	1960		1970		1975		1976	
	DD	*DS*	*DD*	*DS*	*DD*	*DS*	*DD*	*DS*
DAC Countries	14.3	2.4	57.9	7.6	110.2	18.6	127.1	22.6
of which ODA:	*5.0*	*0.4*	*22.6*	*1.3*	*33.8*	*1.9*	*37.1*	*2.1*
International financial markets	—	—	0.5	—	24.2	3.6	33.5	5.0
International organisations	2.8	0.2	8.1	0.8	19.8	1.6	23.6	1.8
Other	0.8	—	6.4	0.6	18.7	2.2	22.6	2.6
Total	**17.9**	**2.6**	**72.9**	**9.0**	**172.9**	**26.0**	**206.8**	**32.0**

With regard to terms, developing countries' debt and debt service is composed of four main categories: (i) soft ODA and IDA-type debt; (ii) debt arising from non-concessional lending by multilateral institutions; (iii) export credit debt (partly subsidised); (iv) private debt (market terms).

THE TERMS OF DEVELOPING COUNTRIES' DEBT AND DEBT SERVICE

$ billion

	1960		1970		1975		1976*	
	DD	*DS*	*DD*	*DS*	*DD*	*DS*	*DD*	*DS*
ODA/ IDA-type	5	0.4	29	1.4	52	2.2	57	2.6
Other multilateral	3	0.2	5	0.8	12	1.6	13	1.7
Export credits	7	1.7	26	4.9	49	11.3	62	14.0
Private	3	0.3	13	1.9	60	10.9	75	13.7
Total	**18**	**2.6**	**73**	**9.0**	**173**	**26.0**	**207**	**32.0**

Private Debt - A New Factor

Much analysis has gone into the role of official debt which, for many years, has been covered by elaborate reporting systems. A more recent phenomenon, however, is the upsurge in private debt incurred by an increasing number of de-

(1) The assumption is that the immediately repaid discounted debt can be invested by the creditor at the same interest rate at which the nominal debt has been discounted to its present value—conventionally taken as 10 per cent.

(2) The formula is $\frac{2}{(m) + 1}$ *where m = maturity of the loan.*

(3) For a fuller analysis, see "Debt Problems of Developing Countries", OECD 1974.

veloping countries to meet the severe strains on their payment balances caused by the quantum jump in oil prices, world recession and deteriorating terms of trade. Over 60 developing countries have used their credit-standing to attract large volumes of Euro- and private bank credits.

The upsurge in such inflows of commercial capital has saddled several of the borrowing countries with a level of debt whose current cost and maturity structure may cause difficult servicing problems in the future. Some of these countries have used the borrowed funds partly to finance current imports, and several of them have not yet completed the adjustment process necessary to absorb higher import prices.

A number of developing countries may by now have come close to reaching the limits of their creditworthiness for additional debt, and some of the lending banks have reached what they consider reasonable, though quite flexible, exposure limits with respect to certain borrowers. Except for export-related credits, private banks do not have access to official guarantees from the government of the country in which they are domiciled in the event of a default—a fact which may have sharpened their perception of the borrower's creditworthiness.

The international banking community has so far shown a remarkable willingness and ability to act as financial intermediary between the surpluses of the OPEC countries and the borrowing needs of developing (and some developed) countries. It has often found lending to developing countries more profitable than to developed countries because of the higher interest rates and the fees and commissions which banks have been able to charge. They have been willing to assume the corresponding risks as well as the task of lending and credit evaluation which OPEC countries have shifted to them. There is, however, a growing feeling in banking circles—exacerbated by official warnings—that private banks cannot continue to expand their role as financial intermediaries at an undiminished pace.

Banks themselves have diversified their portfolios, concentrating increasingly on countries having well-managed economies. Syndication of Eurocurrency credits (often involving 30-50 banks for a single loan) has also helped markedly to spread the lending risk. Moreover, while individual banks may have a large, and possibly excessive, exposure vis-à-vis individual developing countries, the banking community at large in most OECD countries is only marginally involved in lending to developing countries.

So far, the developing countries themselves have demonstrated an excellent debt servicing record with respect to the private banks. As a rule, private bank debt has been serviced on schedule and the banks' general experience with international lending has been considerably better than for domestic lending.

It is also interesting to note that several developing countries have preferred private bank lending to the International Monetary Fund's credit facilities. They have far from exhausted their access to the IMF facilities especially in the higher credit tranches which are associated with progressively more stringent conditions. The preference for bank credits may be attributable not only to the relative ease with which they can be obtained but also to the desire of the borrowers to avoid the stringent conditions of IMF assistance since private bank credits do not require formal commitments by the borrowing country as to the pursuit of specific economic and financial policies (though these are increasingly a key factor in the banks' credit assessment).

For countries with well-managed economies, the current interest cost of private bank lending can be more than absorbed by the rate of return on investment projects: although the average interest cost on private debt outstanding is currently around 9 per cent—twice what it was ten years ago and 2 ½ times as high as on official debt—the rate has not fully kept up with inflation. The main drawback of private bank loans is their short maturities, but if the borrowing country keeps up its credit-standing, roll-over will effectively turn medium-term bank credits into long-term funds.

The future role of private banks as capital suppliers for developing countries will depend on the external capital needs of the borrowers and the availability of alternative sources of finance as well as on the supply of loanable funds and the lenders' evaluation of the credit risk. This latter judgement is necessarily somewhat uncertain. There is no magic formula for assessing credit risks even if all the basic information were readily available, which it is not, though private banks increasingly rely on information now being made available to them by the World Bank, the IMF, the BIS and the Regional Development Banks.

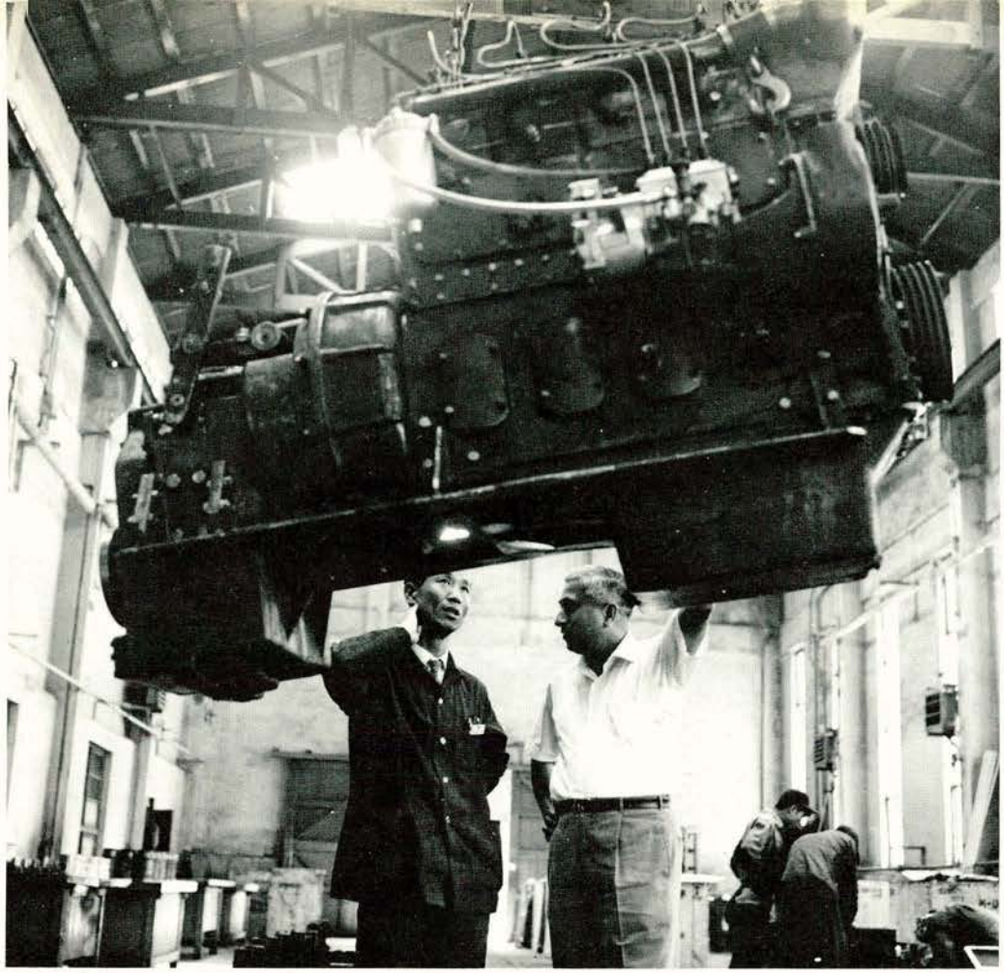
There is every indication that international private banks will roll over the borrowers' repayments on past loans unless there is a collapse of confidence, a political crisis or some other severe disturbance. Developing country borrowers with good credit standing are not expected to be crowded out by other borrowers. It is anticipated that banks as a group will make net new loans to developing countries (also taken as a group). However, while some of the banks heavily involved in lending to the developing countries may wish to curb their future exposure, others have come onto the scene as new lenders. Similarly, some developing countries having a large volume of private debt may not wish to increase such debt further, but other developing countries will come onto the market as borrowers.

Debt Servicing: Avoiding the Difficulties

The key to sound debt management is to determine whether or not the country's expected current account deficit, associated with its development programme, is consistent with its ability to sustain the servicing of external capital inflows. Debt management thus depends in the final analysis on the basic strength of the debtor country's domestic economy, and especially its ability to generate savings for investment, to use investment capital efficiently for growth and to generate adequate export earnings.

Some developing (and developed) countries are still coping with the adjustment process imposed upon them by higher oil prices and other disturbances in international economic relations. The developing countries face the problem of having large contractual debt servicing obligations—over $100 billion for the non-oil producers as a group over the 1978-80 period—with no assurance that an economic upswing in the OECD countries will be strong enough to provide them with export earnings sufficient to service their debt. Nor can they be sure that the industrialised countries will provide additional external capital in adequate volumes and on reasonable terms.

Aside from pursuing effective economic and financial policies, developing countries can considerably strengthen their debt management with a number of technical measures directly designed to assure control and surveillance of their external debt. These measures include screening procedures—to ascertain that foreign loans are only contracted for high priority projects—prior authorisation schemes for public loans and, for private loans, at least central registration. This would permit a continu-



South Korea is among the countries that have borrowed most heavily; the external funds however have been productively invested in increasingly sophisticated goods for export.

ous check on overall indebtedness and service obligations as well as projections of future debt service payments. Acute difficulties, due for example to "bunching", can thus be foreseen and corrective action taken in good time.

Coping with the Problems

While there is every indication that the large majority of developing countries will be able to cope with their external financing problems, it is likely that a few of them may face a situation which calls for debt relief by their creditors.

It is to be expected that, as in the past, the creditor community will respond constructively to individual requests by developing countries for such relief. From 1956 to 1977, 12 developing countries sought and obtained debt relief in a multilateral context; 37 debt renegotiations took place involving a total of over $9 billion of rescheduled debt service. In addition, some 60 developing countries benefited from bilateral debt relief extended by DAC countries, involving a total of over $1.2 billion of renegotiated debt service: a quarter was cancelled and the remainder rescheduled, at ODA and non-ODA terms in roughly equal parts. All of these have been on a case-by-case basis.

More recently, notwithstanding the case-by-case approach, Canada and Sweden have cancelled the ODA debts of a *group* of poorer countries amounting to $254 million and $200 million respectively. Switzerland and the Netherlands hae taken similar action.

The basic attitudes which have in the past guided the action of creditor countries with respect to debt relief—and will probably do so, for most of them, in the future—may be summarised as follows (4):

- Balance-of-payments problems of developing countries should be solved essentially through sound balance-of-payments policies and adequate provision of new external resources, including IMF facilities, rather than through debt relief: in the absence of fundamental remedies, debt relief may be no more than a palliative. Lenders are averse to determining the volume and geographical allocation of their new resource flows as a function of the accidental pattern of their recipients' debt structure.
- Avoidance of debt renegotiation is in the interest not only of the creditor but also of the debtor countries. For the latter, it is essential to safeguard their credit standing and thereby the future inflow of external resources. Debt relief should therefore be a highly exceptional measure of last resort to enable the debtor country to continue its debt service payments without a serious disruption of its growth momentum.
- Given the wide diversity of debt situations, each case has to be examined on its merits to determine eligibility for debt relief and the terms and conditions under which it will be provided.
- Debt reorganisation should generally be conducted within existing multilateral fora: "Creditor Clubs" to meet acute debt crises and "Aid Groups" to deal with longer-term development problems.
- The modalities of debt relief should take into account both the anticipated long-term debt-servicing capacity of the debtor country and the legitimate interests of the creditors; the modalities of debt relief include:

— The type of debt whose service payments will be rescheduled (the so-called "assiette");
— the consolidation period, i.e. the period for which service payments are subject to rescheduling;
— the "cash quota", i.e. that part of the service payment which is *not* subject to debt relief, and
— the terms and conditions (interest rate, maturity and grace period of the rescheduled debt service).

- Debt relief should be accompanied by an effective stabilization programme on the part of the debtor country, preferably in the context of an IMF standby undertaking.
- Debt relief should be based on the principles of non-discrimination and equality among all bilateral creditors, but small creditors—frequently other developing countries—would generally be excluded from multilateral debt renegotiations.

At the CIEC, both developing and developed countries submitted detailed proposals on the debt problem. The former put forth a number of procedures for initiating international action and for analysing a country's long-term economic situation, as well as guidelines and institutional arrangements for reorganisation operations. Some of the industrialised countries submitted a list of features which could be used to characterise default situations requiring immediate debt reorganisation and also advanced proposals for remedial measures to deal with situations of a longer-term nature. While these proposals naturally differ on essential points, some of them cover common ground.

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(4) For further details see "Debt Problems of Developing Countries", Report of the Ad Hoc Group of Governmental Experts, UNCTAD, United Nations, 1975.

TARIFF PREFERENCES FOR THE DEVE
Operation and Evolution of the Generalised

by Jacques de Miramon and Anthony Kleitz (1)

OECD countries have recognised that trade is as crucial to the economic growth of the developing coun treatment to the imports of these countries. It is a policy for which the groundwork was laid at the beginning fruit. At the second session of the United Nations Conference on Trade and Development (UNCTAD) held ir tion of a Generalised System of Preferences (GSP) in favour of imports from developing countries. Between OECD initiated their national schemes putting this system into effect. The first results of the GSP have now b

Nineteen OECD Member countries now allow a broad range of goods manufactured in the developing countries to be imported duty-free or at reduced rates. The preference-giving countries have pledged to keep this system in force for an initial period of ten years. Thus within a few years they will have to decide whether to prolong it and, if so, in what form.

When the industrialised and the developing countries agreed to set up a system of generalised tariff preferences, they had three basic objectives (2):

- to increase the developing countries' export earnings
- to promote their industrialisation
- to accelerate their rates of economic growth.

Have preferences actually helped to achieve these objectives? Some experts hold—and their view is widely echoed in the developing world—that the effects of the GSP have been disappointing. Is this a valid objection? How might the system develop in future?

The GSP has Developed Dynamically

The first GSP schemes came into being in 1971-1972 (3) after six years of discussions, not only with the developing countries but also between industrialised countries. These schemes attempted to preserve an overall balance between different practical approaches. Indeed it could not be expected that Member countries having very different economic structures and tariff protection systems could implement an identical set of concessions in favour of the Third World countries.

The preferences schemes represented a delicate compromise between the developing countries' desire to have the fewest possible obstacles to market access and the fear, in economic circles of the industrialised countries, that a general tariff "disarmament" would create serious disruptions. Initially, the developed countries considered their preference schemes as a set of intangible and hence static concessions, but they eventually accepted the developing countries' request to create a system that could evolve. As a result, the GSP has both changed and developed during its six years of operation and has continued to do so despite the economic crisis.

This dynamism is evident in the numerous changes that have been made in the *structure* of the schemes as well as in their increasing *effect* on trade flows.

Structural Improvements

Since each of the schemes implemented by Member countries has its own characteristics, improvements have neither been similar for all preference-giving countries, nor concerted. There has however been some convergence of the measures taken by the preference-giving countries which on the whole have improved access to their markets. The main elements of the GSP on which these improvements focus are summarised in the box to right.

• *Extension of beneficiary lists*

The problem of who should benefit from the preference system was an important one from the start and was discussed even before the actual nature of the system had been established. The developing countries wanted very flexible criteria of a political rather than economic character. They asked for every Member of the Group of 77 (4) automatically to be considered as a beneficiary. After protracted discussions, the preference-giving countries got the developing nations to agree on a formula which would preserve their autonomous right to grant, refuse or withdraw the benefits of preferential treatment for any given country.

Initially, there were rather marked discrepancies between the beneficiary lists, usually involving developing countries not belonging to the Group of 77 (Southern European and Mediterranean countries, planned-economy countries, dependent countries or territories which did not belong to the United Nations at the time).

One sign of the dynamism of the GSP is the gradual extension of the original list of beneficiaries. Three schemes now accept all members of the Group of 77 as beneficiaries. Five others exclude a single member of the Group (North Korea in the case of four of them). Five members of the Group of 77 are excluded by Canada and Japan and 20 by the United States.

After some hesitation, the donor countries have gradually extended the benefits of their schemes to a large number of countries outside the 77. Since several of the candidacies (Hong

(1) Head of OECD's Division on Trade Relations with non-member countries and principal administrator in that division respectively.

(2) Resolution 21 (II) - 2nd UNCTAD Conference held at New Delhi, 1968.

(3) EEC (the Six), Austria, Denmark, Finland, Ireland, Japan, New Zealand, Norway, Sweden, Switzerland and the United Kingdom. Australia had introduced a preference scheme in favour of the developing countries in 1966, within the framework of GATT, and in 1974 placed it under the same GATT waiver as the other OECD countries. In 1974, Denmark, Ireland and United Kingdom adopted the EEC system. Canada introduced its GSP in 1974, and the United States in 1976. At present, there are 11 different schemes in operation.

(4) The Group of 77 was set up in 1964 by the developing countries taking part in the 1st UNCTAD Conference. This political-affinity grouping at present comprises 113 Member, with widely varying levels of economic development.

LOPING WORLD: System of Preferences

ries as aid and have agreed to accord special tariff of this decade but which is only now beginning to bear 1968, international agreement was reached on the crea- July 1971 and January 1976, the developed countries of een analysed within OECD and are presented below.

Kong, Taiwan, Israel, Malta, Rumania, Bulgaria and the developing countries of OECD) raised special problems, this was done on a case-by-case basis, and the treatment accorded them is less uniform than for the 77. They are not always included in all OECD country schemes and, when they are, the benefits are often less than for the other developing countries.

At present, 126 countries and some hundred territories enjoy preferences in at least one preference-giving country, but 30 of the countries are still excluded from at least one of three biggest markets (the EEC, Japan or the United States).

The beneficiary lists now include countries having widely differing levels of economic development, and the question arises whether it is equitable to grant identical preferential treatment to all these countries. This problem will be discussed again in the context of the increasing differentiation within the schemes.

• *Enlarged product coverage*

Since all dutiable products were not included in the schemes from the outset, another way of improving the GSP was to *extend the lists of products covered.*

As is shown in the New Delhi resolution, one of the main objectives of those promoting the GSP was to accelerate the industrialisation of the Third World. When drawing up the schemes that would be proposed to the developing countries, the OECD Member countries agreed on two general principles: preferences would cover all industrial products *except* for a small number of "sensitive" goods which would either be excluded from the system or given special treatment. As to non-industrial products, the decision of whether or not to include them in the schemes (5) would be decided on a *case-by-case* basis. Thus the list of such products receiving preferential treatment, though varying in length from one scheme to another, is generally fairly short.

(5) In order to distinguish between these two groups, Chapters 1-24 of the Brussels Tariff Nomenclature are generally considered to represent non-industrial products (unprocessed and processed agricultural products) and Chapters 25-99 to represent industrial products.

MAIN FEATURES OF THE GENERALISED SYSTEM OF PREFERENCES

OECD countries operating a GSP scheme

Australia, Austria, Canada, EEC, Finland, Japan, New Zealand, Norway, Sweden, Switzerland, United States.

Beneficiary countries

A list of eligible beneficiary countries is established by each preference-giving country. In general, members of the Group of 77 are included. The four developing Member countries of OECD and certain Eastern European countries are also beneficiaries of some schemes. Treatment of dependent territories varies.

Product coverage

• *Agricultural products:* in general, only specified agricultural products are included in the schemes.
• *Manufactured products:* in general, all manufactured products are included, unless specifically excluded; products excluded from many schemes are textiles, footwear, leather products.

Preferential tariff treatment

The level of tariff cuts for GSP imports varies according to the scheme:
• *Totally duty-free treatment:* Finland, Norway, Sweden, United States
• *Generally duty-free treatment with some exceptions:* Japan, Switzerland, EEC
• *Duty-free treatment for some products, but general rule is less than duty-free:*
Australia, Austria, Canada, New Zealand.

Safeguard provisions

Four kinds of safeguards are provided for under the various schemes (figures in parentheses indicate the number of schemes in which each type is found).
• *Quantitative limitations:* global tariff quotas or ceilings for particular products (3); maximum amounts for individual beneficiaries (2)
• *Specific product exclusions for particular beneficiaries:* exclusions according to prescribed conditions (such as "competitive need", where certain countries are considered to be competitive producers) (2); reduced product coverage for specificied beneficiaries (6)
• *Reduced preferential margins for specified beneficiaries (2)*
• *General safeguard clause (10)*

Rules of origin

Each preference-giving country has established rules to ensure that GSP treatment is only accorded to goods which are actually produced in a beneficiary country. In general, these rules are based on the following elements:
• *Substantial transformation* of the inputs in the beneficiary country
• *Direct consignment* to the preference-giving country, with exceptions allowed under certain conditions
• *Appropriate documentary evidence,* generally based on the presentation of a special standardised certificate of origin
• *Administrative cooperation* with the customs authorities of beneficiary countries.

Other elements included in several schemes are:
• *Donor country content,* allowing components originating in the preference-giving country to be counted as if they originated in the beneficiary country.
• *Cumulative treatment,* allowing GSP treatment to be granted to goods produced by several developing countries in collaboration.

It was apparent, however, that, if tariff preferences were limited to industrial products, only a tiny fraction of the exports of the least industrialised countries would benefit. Hence there was pressure from the Group of 77 to enlarge the list of primary and semi-processed agricultural products; many have in fact been incorporated into the GSP over the years. Among them are concessions made recently by several Member countries on tropical products in the context of the Tokyo Round.

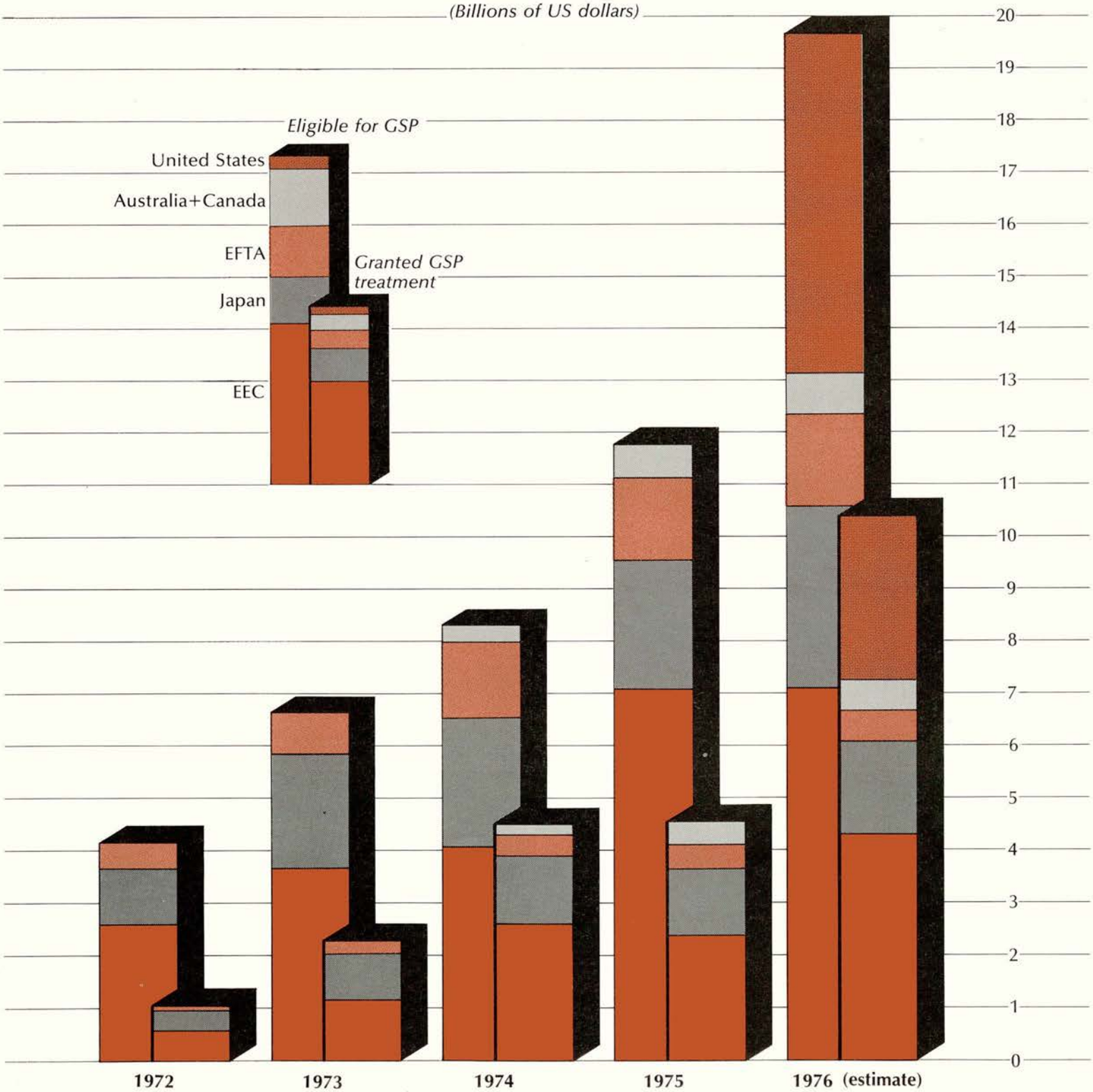
Althought it is difficult to compare customs tariffs having different structures, the present situation may be summed up as follows. Out of all dutiable *industrial products* (Chapters 25-99 at the 4 digit level) the percentage *excluded* from the GSP ranges from 0.2 to 9 per cent, depending on the scheme; as to *agricultural products* (Chapters 1-24 at the 4 digit level) between 12 and 86 per cent are either *included* in the GSP or duty free on a normal basis (GATT most favoured-nation tariff rate).

Thus relatively few industrial products are excluded from tariff preferences, more than half of the exclusions being in textiles; footwear and leather products are often excluded as well. For agricultural products on the other hand, the situation varies more widely from one scheme to another.

• *The preferential margin*

The preference-receiving countries are particularly attracted by the idea that the GSP offers them an advantage over other

A. OECD IMPORTS UNDER THE GSP, 1972-1976



foreign suppliers in the preference-giving country market. They focus on the *preferential margin*—the difference between the duty imposed on a product originating in a third country and subject to the normal customs system (most favoured nation rate) and the preferential customs duty. But in so doing, they neglect another aspect of the system which is no less important—the possibility of improving their competitive position vis-à-vis the producers of the importing country. From this point of view, the GSP can be considered as an anticipation for the developing countries of the general elimination of customs duties towards which the industrialised countries are working.

Unless the preference-giving countries had granted duty-free entry at the outset for all products included in their schemes, they were subsequently able to *lower the level of the preferential duties*, thus improving the preferential margin on products imported from the developing countries by comparison with those from third-country suppliers.

However determined and far-reaching Member countries' efforts to improve the tariff concessions offered under their GSP, it is nevertheless apparent that such action is bound to reach a limit with the gradual decline of normal customs tariffs. Preference-giving countries consider, moreover, that the aim of liberalising trade barriers on an overall basis should not be subordinated to the maintenance of preferential tariff margins in favour of developing countries. The average level of tariffs of the main OECD countries has fallen considerably over the last 30 years and is now equal to or less than 10 per cent. If the Multilateral Trade Negotiations now in progress have a favourable outcome, customs tariffs will be reduced yet again.

There are, of course, a few isolated instances of higher protection (duties of between 15 and 30 per cent) which have withstood liberalisation. However, since the products involved are usually considered to be sensitive ones, the preference-giving countries find it difficult to include such products in their preference schemes and, when they do, the preferential treatment is frequently limited.

The theoretical possibilities of a GSP are limited by another trend—the creation of vast free-trade areas, mainly for industrial products, not only among the industrialised countries but between these countries and certain groups of developing countries. Thus, tariff concessions for GSP beneficiaries exporting to the EEC are no more generous than those accorded to EFTA countries, to most Mediterranean seaboard countries or to the Associated African, Caribbean and Pacific countries. The fact that they benefit from the GSP, however, reduces very substantially the discrimination from which they would otherwise suffer as developing countries not party to these regional arrangements.

• *Safeguard mechanisms*

One of the essential points on which the industrialised countries insisted at the inception of the Generalised System of Preferences was the option to refuse to grant tariff cuts if such a measure would be prejudicial to their economies. This notion implied that they would be free either to exclude certain products from the system at the outset, or to alter the distribution of its advantages—by country or by product—at a later date. The mechanisms by which these adjustments can be made are called *safeguard mechanisms;* they may take several forms and are one of the main causes of the differences between the various schemes.

Three schemes contain more or less automatic quantitative limitations as part of their ordinary operation procedures; eight contain mechanisms for excluding certain products from preferential treatment when necessary and vis-à-vis certain countries. Two apply reduced preferential margins for certain countries, and ten schemes contain a general safeguard clause. As is apparent, these diverse mechanisms can be combined. All are extremely complex, and description of them is beyond the scope of this article. They are strongly criticised by the developing countries on two counts. First, they restrict use of the system by very dynamic exporters to a level well below their capacity even though the ceilings or quotas are not always fully utilised. For all beneficiaries they create an aura of insecurity around the GSP which discourages the developing countries from basing a long-term trade policy on its use.

It is important not to generalise with regard to the functioning of the safeguard mechanisms. The strength of their effect depends on the scheme, the product and the beneficiary country. Analysis of the main schemes using quantitative limitations with regard to certain countries— those of the EEC, Japan, the United States and Australia—shows that the effects of such limits are concentrated on some 15 relatively competitive developing countries.

There have also been adjustments to the safeguard mechanisms which have made their administration more flexible. Thus, two of the systems which contain quantitative limitations—those of the EEC and Japan—have substantially increased the amounts of the quotas by updating the statistical formulae used to calculate them. For the EEC, the base year, originally 1968, is at present 1974; Japan, which until 1976 based its calculations on its 1968 import trade, now uses 1975 as the base year. In the case of the EEC, this has allowed the nominal value of quotas to be increased by 41 per cent in 1977, and in the case of Japan by 80 per cent. At the same time, the EEC and Japan have reduced the number of products subject to strict quota control and introduced a system of "flexible administration" which permits preferential treatment to continue even when the nominal amounts have been exceeded.

• *Other improvements*

In several schemes, a particularly liberal arrangement has been introduced recently for the 25 countries considered by the United Nations to belong to the "least developed" group. In 1976, Norway granted these countries duty-free treatment for all their exports without exception, whether agricultural or industrial. In 1977, the EEC allowed quantitative limitations on various industrial products and textiles to be waived for these countries.

Seven preference-giving countries (6) supplement the GSP with a preferential import system for certain handicraft products and/or handwoven textiles from the developing countries.

Lastly, preference-giving countries have endeavoured since 1971 to simplify and harmonize the rules of origin applied to products subject to preferential treatment.

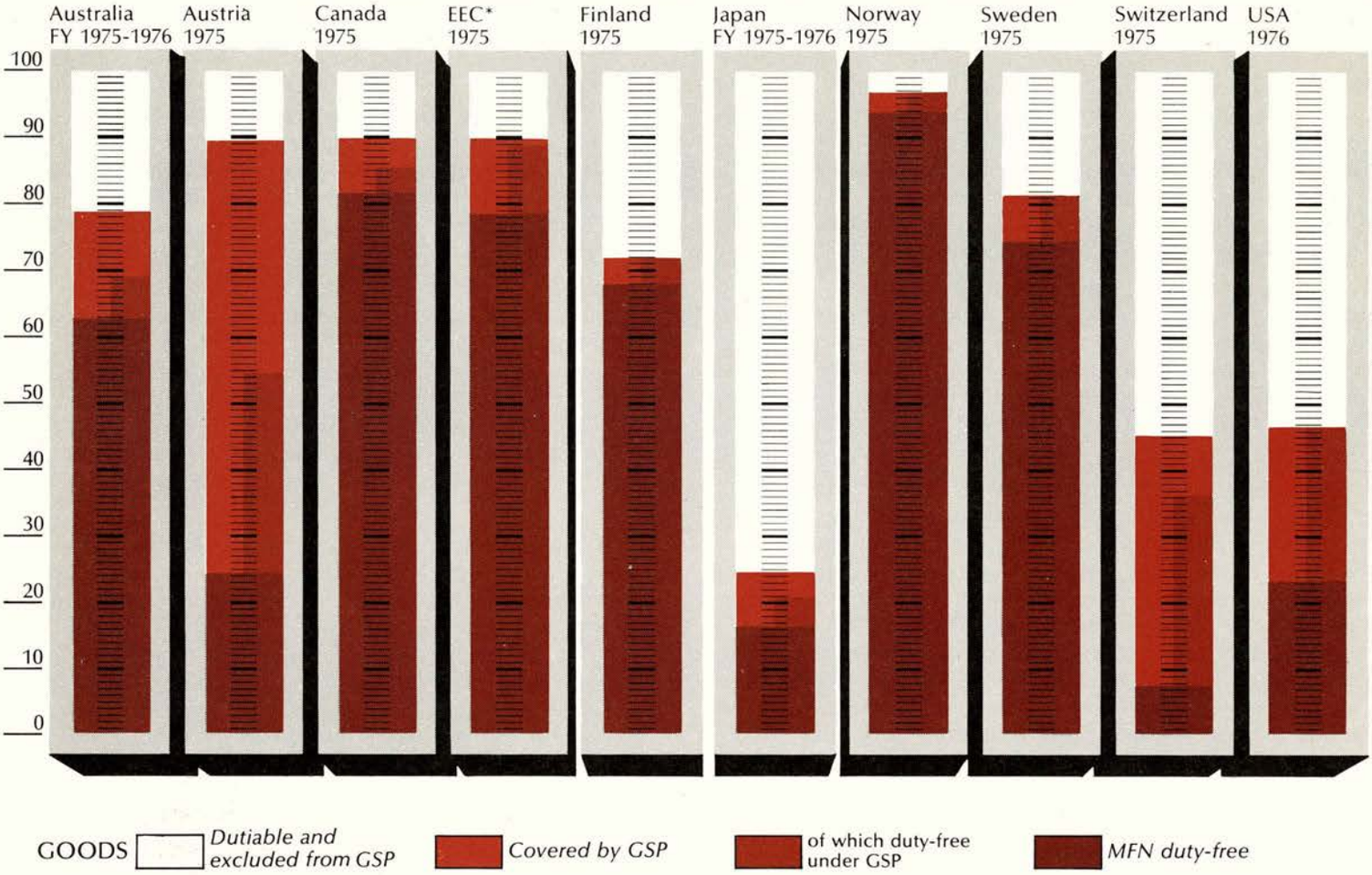
Effect on Trade Flows

Has the GSP also proven dynamic in its effects on the developing countries' export earnings? Although sufficiently detailed and consistent statistics are not yet available for all schemes, data collected by the OECD Secretariat can help to trace these effects.

Generally speaking, imports of the preference-giving countries from the developing nations did increase between 1972 and 1976— as shown in table 1, they tripled. This is clearly due in part to the increase in oil prices and commodities. But manufactured products have also been a dynamic factor in this

(6) Australia, Austria, Canada, EEC, Finland, New Zealand, Switzerland.

B. TARIFF TREATMENT OF IMPORTS FROM GSP BENEFICIARIES



* *Percentage for MFN duty-free imports has been estimated.*

growth as shown by the fact that the developing countries have increased their share in the preference-giving countries' imports of such products from 9 to nearly 15 per cent.

The GSP has played an increasing role in the growing trade flows from the developing countries. Here one must distinguish between imports which *could theoretically benefit* from preferential treatment if the conditions making them eligible were met—and those *actually accorded preferential treatment under the GSP* i.e. products which have been accepted by the customs of the receiving country as conforming to these conditions (see chart A).

To take the latter first, such imports for all the OECD schemes operating in 1972 hardly exceeded $1 billion. They reached $4.4 billion in 1975 and seem, on the basis of preliminary figures, to have exceeded $10 billion in 1976—ten times more than in the first year.

Such sizeable growth is certainly due to a conjunction of factors which will not recur: the step-by-step inauguration of the schemes, especially the impact of the United States plan in 1976; the slowness of exporters to take advantage of the system and the subsequent catching up and various improvements introduced by OECD countries. It is possible, therefore, that the growth will stabilize over the next several years.

It is significant that in 1976, the first year in which all eleven schemes were operating at the same time, the growth in imports of products *eligible for GSP treatment* was particularly strong compared to that of overall imports from the beneficiary countries. Imports of these products increased about 26 per cent compared with 1975, assuming constant product coverage (7). During the same period, overall OECD imports from all developing countries rose by 19.4 per cent and those from the entire world by 16.3 per cent.

Unfortunately, it is not possible, with the information available, to measure how much imports of specific products covered by the GSP have increased as a result of preferential treatment. What is clear is that these products represent a dynamic element in the exports of developing countries towards preference-giving countries. On the other hand, table 1 shows that, despite their rapid growth, imports *eligible for GSP treatment* account

1. IMPORTS BY OECD PREFERENCE-GIVING COUNTRIES (1)

Billions of U.S.$

	Total imports from world	*Total imports from developing countries (2)*	*Imports from beneficiaries of operating GSP schemes*		
			total	*eligible for GSP*	*accorded GSP treatment (4)*
1972	205.1	62.4	35.0	4.1	1.0
1973	280.9	90.4	52.7	6.6	2.2
1974	413.8	168.2	105.7	8.3	4.3
1975	408.1	163.1	104.5	11.8	4.4
1976 (3)	474.6	194.7	146.2	19.7	10.1

(1) Excludes New Zealand.
(2) Including the 4 OECD developing countries.
(3) Preliminary figures.
(4) Also excludes Australia.

(7) Calculation based on products eligible for the GSP in 1976, whether or not they were eligible in 1975 and even though the U.S. scheme was not operational in 1975.

for a relatively small share of overall imports from the beneficiary countries (13.5 per cent in 1976). The imports which *have in fact received preferential treatment under the GSP* represent a still smaller share—2.9 per cent of overall imports from the beneficiary countries in 1972, increasing to 7.1 per cent in 1976. How then can one explain the fact that, in value terms, 93 per cent of the goods imported by the preference-giving countries from GSP beneficiaries do not enjoy preferential treatment?

The main explanation is the substantial share of imports from the developing countries which benefit from free entry under the normal most-favoured-nation (MFN) rates and which cannot therefore be accorded preferential treatment. Although the share varies sharply from one preference-giving country to another (see chart B) on average 54 per cent of the imports of preference-giving countries from beneficiaries of the GSP were admitted duty free at the most-favoured-nation rate in 1975-76.

Of those imports into OECD preference-giving countries which were subject to duty under the normal GATT rules—46 per cent of all imports—over two thirds (33 per cent of overall imports) consisted of products which were not included in the GSP for various reasons. This is the second cause of the relatively small volume of commerce affected by preferential treatment. The third has to do with the fact that only about half of the imports eligible for GSP treatment *actually benefit* from preferential treatment (7.1 per cent out of the remaining 13.5 per cent).

It may seem surprising that actual *use* of the opportunities afforted by the GSP is not greater. Various reasons have been advanced: ignorance on the part of exporters of the existence of the schemes; negligence in observing the required formalities; lack of interest in small preferential margins; rules of origin which often exclude preferences when production is shared among several countries; and the strictness of safeguards which leave some of the theoretical benefits of the system unused.

The fact that full use is not being made of the opportunities offered has not escaped the attention of industrialised countries which have given priority to increasing the rate of utilisation of their schemes. But they cannot do it solely by taking steps to increase access to the GSP or making its administration more flexible. Since according preferential treatment follows on a decision (to send, together with the consignment, a certificate of origin countersigned by customs authorities) which can only be taken by the exporter himself, it is not reasonable to expect a utilisation rate of 100 per cent.

The GSP is under-utilised not only on overall basis but also by the vast majority of countries on the beneficiary lists: use is strongly concentrated on only some ten developing countries. A survey covering seven schemes reveals that, in 1975, ten developing countries were supplying two-thirds of GSP imports. The first five of them—Yugoslavia, Hong Kong, Brazil, South Korea and India in that order—accounted for approximately 45 per cent of GSP imports (see table 2). Following the implementation of the American scheme in 1976, Taiwan is likely to occupy first place.

The ten main users of the GSP are also among the major developing country exporters of manufactured products to

2. MAJOR DEVELOPING COUNTRY SUPPLIERS OF GSP PRODUCTS AND MANUFACTURED GOODS

Imports of OECD Preference-Giving Countries

	GSP imports (1) 1975 all products		*All imports (2) of manufactures (3)*					
			Value $million			*Share of manufactured imports from all developing countries (4) per cent*		
	Value $million	*Share of total GSP imports %*	*1967*	*1971*	*1975*	*1967*	*1971*	*1975*
I. From major beneficiaries of the GSP								
Yugoslavia	391	12.7 %	221	502	1,127	5.8	5.4	4.4
Hong Kong	281	9.1	922	1,833	3,710	24.4	19.9	14.5
Brazil	251	8.1	84	200	1,000	2.2	2.2	3.9
South Korea	234	7.6	146	647	3,041	3.9	7.0	11.9
India	220	7.1	418	475	830	11.1	5.2	3.2
Rumania	153	5.0	63	236	658	1.7	2.6	2.6
Singapore	124	4.0	16	165	894	0.4	1.8	3.5
Pakistan	119	3.9	104	191	275	2.7	2.1	1.1
Mexico	98	3.2	176	533	1,763	4.7	5.8	6.9
Malaysia	92	3.0	21	58	475	0.6	0.6	1.9
II. From other important suppliers of manufactured products								
Spain	77	2.5	333	1,096	3,133	8.8	11.9	12.2
Portugal	—	—	247	454	1,110	6.5	4.9	4.3
Greece	11	0.4	53	172	779	1.4	1.9	3.0
Israel	22	0.7	73	193	404	1.9	2.1	1.6
Taiwan	4	0.1	160	1,040	2,993	4.2	11.2	11.7
TOTAL I + II	2,077	67.4	3,037	7,795	22,192	80.3	84.6	86.7
III. From all developing countries (4)	3,083	100.0	3,782	9,212	25,594	100.0	100.0	100.0
IV. From world			**45,397**	**85,791**	**174,633**			

(1) GSP imports are those which are accorded preferential treatment under the GSP.
Excludes GSP imports into Australia, Japan and New Zealand. There were no GSP imports into the United States in 1975 as the US GSP was not yet operative.
(2) Excluding imports into Australia and New Zealand.
(3) SITC 5 to 8 minus 68 and 667.
(4) Including the four developing Member countries of OECD.

OECD countries (see table 2). Is there a correlation then between the granting of the GSP and export performance? It is hazardous to draw conclusions from a trend which covers only a few years and is marked by a steep decline in the rates of growth of international trade in 1975. Moreover, trade figures show trends which vary from country to country.

Some of the traditional exporters of manufactured goods to the OECD (Hong Kong, Yugoslavia, India and Pakistan) have made intensive use of the GSP, although their share in total imports of manufactures into OECD preference-giving countries has fallen. Their ability to use the GSP from the outset is probably due to their greater experience in trade, to geographical proximity, in the case of Yugoslavia, and to the fact that their products fitted the opportunities provided by the tariff preferences. South Korea, Singapore and Mexico are maintaining their rank among the leading suppliers of OECD countries, their utilisation of the GSP apparently having improved in step with the rather substantial growth in their total exports. Brazil and Malaysia are interesting because their exports of manufactured goods to OECD countries have increased at a rapid rate since 1971, parallelling an intensive utilisation of the GSP.

What of the Future?

The developing countries express disappointment in the performance of the GSP, at least when they present their collective point of view at UNCTAD and in other international fora. However, they are convinced that preferential trade treatment is a good way of achieving economic development and propose to extend the technique to other areas such as non-tariff measures and trade between Third World countries.

What is the best way of enabling the developing countries to export more—and more advantageously? To improve further the *formal* benefits of the GSP, i.e. to include a larger number of the products which are important to these countries? To improve the customs concessions granted to products included in the system? To make the safeguard measures and conditions of origin less strict? These are the kinds of improvements advocated by the developing countries when, in international fora, they hold firmly to their long-standing demands: a GSP which is as "generalised" as possible, i.e. which offers all the developing countries, without exception, unlimited and duty-free access to all the markets of the industrialised countries for all their products; a permanent and contractual system recognised by the international community as a right for the developing countries and, therefore, an obligation for the industrialised countries.

The position of OECD countries is that the principles on which the GSP is based must be preserved. They want the system to remain *autonomous* and *non contractual* since no reciprocity is asked of the beneficiaries. They also want it to be *temporary* since it is designed to compensate for handicaps which will tend to disappear as the exporting countries grow. It should not therefore create *inherent advantages* for any group of countries nor assume that the trend towards general elimination of world tariffs will be slowed down.

From this point of departure, Member countries have adopted an open and pragmatic attitude with regard to the future of the GSP.

As already noted, they have considerably expanded the system over the six-year period. While present economic circumstances make it difficult to continue improvements at the same pace, the preference-giving countries have not abandoned their intention gradually to adapt the GSP so that it corresponds more closely to the real requirements of the beneficiaries. In short, Member countries consider that the experience has been a positive one and that the GSP remains a major vehicle for their trade policy vis-à-vis the Third World. They are prepared to envisage granting tariff preferences beyond the initial ten-year period, bearing in mind the parliamentary authorisations which could be required. It is important, however, not to have any illusions that generalised preferences can of themselves "accelerate economic growth".

To repeat the obvious: the GSP is a trade mechanism relating exclusively to tariffs. It can only be applied where tariffs still exist, and it is common sense to recognise that the preferential margin is only one of the factors which determine the competitive position of products supplied by the developing countries. It is important to compare the relatively modest size of this margin with other factors entering into the cost of the imported product—monetary parities, labour costs, transport costs, marketing margins, etc.

It can be argued that a relatively large portion of the developing countries' trade—a third of all imports of OECD preference-giving countries on average—are not eligible for GSP concessions and are still subject to customs duty. Why could preferences not be granted on these products? The products involved are raw materials, particularly petroleum, which are taxed more for fiscal than for protectionist reasons; agricultural products (meat, for example); and manufactured goods, with a high concentration in the textile sector and in footwear.

While it would be technically feasible to lower protection in these sectors, it is questionable whether the abolition of customs duties is a necessary or sufficient condition for promoting developing country exports. The example of textiles—which comprise 37.5 per cent of the developing countries' exports of manufactured goods to the OECD countries—clearly shows that these are not exports which require encouragement: they are competitive imports which must be given a place by stepping up the restructuring of industry in the importing countries. However, the present economic crisis has slowed this process down, and the acute sectoral difficulties now being experienced in several Member countries would appear, at least for the time being, to exclude measures which would increase the pressure of imports.

Although not in operation for long, the GSP has clearly demonstrated that it cannot be looked upon as a global system whose effects will be distributed proportionately among all developing countries. Ten of them have emerged as the main users of tariff preferences, despite a set of restrictive measures which were designed precisely to prevent excessive geographic concentration of the advantages.

The question that arises is whether this unequal distribution of the benefits of a system intended to be "generalised" can be allowed to continue. Since economic development is an evolutionary process, some of the beneficiaries of the GSP will at some stage—if they have not already done so—cross the threshold beyond which they should be able to cope with international competition without the benefit of stimuli. The advantages of the GSP ought, on the other hand, to be continued—or even enhanced—for the benefit of those developing countries which have not been able to overcome their structural handicaps.

The pattern of preferences is in fact tending to develop along these lines. After a period when priority was given to overall expansion of the system, the prevailing trend now seems to be to make it more selective and to shape it more to the needs of countries at different competitive levels.

The techniques used vary according to the schemes. The more advanced beneficiaries which have emerged as dynamic exporters are either excluded from the system for specific pro-

ducts, granted a lower preferential margin, or limited in their access to the system through safeguard mechanisms. Some schemes differentiate much more than others, but the trend is clear and in the coming decade could lead to a multi-tiered GSP.

In conjunction with this gradation in GSP treatment, renewed efforts might be made to increase the utilisation rate. Even if 100 per cent use is not possible, both for technical and psychological reasons, a rate of between 70 and 80 per cent could in all probability be achieved, which, in the light of results so far, would mean $3 to $5 billion of additional GSP exports per year. Efforts to achieve this would have to be made by both preference-giving and beneficiary countries.

OECD countries should examine their schemes and their methods of administration in order to discover which measures have had a negative effect on utilisation rates. They could then try to liberalise the mechanisms or make the administration more flexible. Substance should also be given to the new concept of the "security of GSP" which appears in the mutually agreed part of the conclusions to the Paris Conference on International Economic Cooperation (CIEC).

Since dynamism is one of the facets of the GSP, improving its "security" cannot mean guaranteeing the permanence of tariff preferences. But the preference-giving countries could certainly limit the fluctuations of the system (preferential rates are sometimes applicable for only a few months, or even a few weeks in a year), prevent a complicated package of safeguard measures from nullifying preferential import opportunities, warn exporters when a safeguard measure is about to be actuated and reassure exporters not threatened by these measures.

But the effectiveness of the GSP does not depend solely on measures taken by the importing countries. A trade flow will not be created by a tariff concession unless a producer and/or exporter in a developing country decides to take his chances on a new market. The preference acts as an incentive; its effects are not automatic. Developing country governments should therefore support the efforts of their producers and exporters; circulate information on possible GSP concessions and carry out rapidly the administrative formalities required for the certificate of origin. A few developing countries have already made substantial efforts in this direction, and it is no surprise to find that they are also the countries which make most use of the GSP. With the help of the technical assistance that the industrialised countries are prepared to give, the other countries could improve their export activities and circulate information on the GSP in particular.

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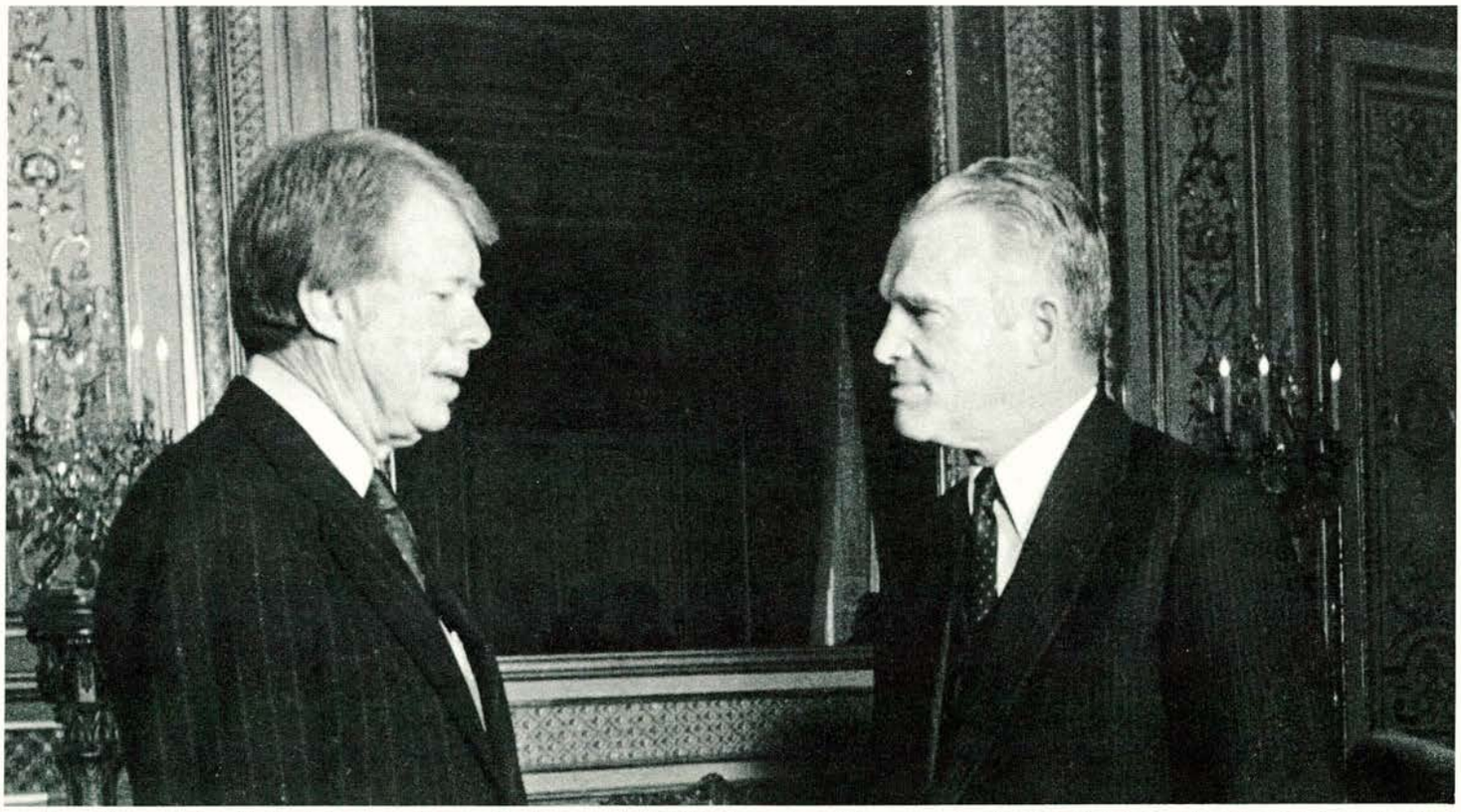
* *

The GSP has proven, after six years of operation, that it is a viable method of intensifying trade between developing and industrialised countries. The developing countries' disenchantment with the system is attributable to the fact that it is complex, that its effects are difficult to determine statistically, that its benefits are unequally distributed and, lastly, that its potential has been exaggerated. Nevertheless, the GSP does constitute a turning point in trade policies with the Third World; it bears witness to the decision, taken jointly by the industrialised countries of OECD, to open their markets to developing country producers and to encourage the growth of trade in manufactured products. The fact that the economic crisis has not slowed the growth of imports of products receiving GSP treatment, and that preference-giving countries have maintained or even improved their concessions lends a note of hope to the world trade picture.

PRESIDENTIAL VISIT



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