the OECD OBSERVER

The Future of Social Expenditure

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EDITORIAL OFFICES
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EDITOR: Jane Bussière

ASSOCIATE EDITOR:
Ulla Ranhall-Jeanneney

ART, PRODUCTION AND LAYOUT:
Marc Delemme

ASSISTANTS:
Rina Maiden,
Gérald Tingaud

PHOTO RESEARCH:
Silvia Thompson Lépot

All correspondence should be addressed to the Editor

PHOTOS: page 6 (top): Jean-Pierre Laffont-Sygma; (bottom): J. Maillard-ILO; page 8: Shannon Development Authority; page 9: Frilet-Sipapress; page 10: (top): Salgado Jr.; (bottom): Alan Keler-Sygma; page 12: Isbir Holding; page 14: J. Maillard-ILO; page 15: Almasy; page 20: Gérard Rancinan-Sygma; page 21 (left): Ray Witlin-United Nations; (right): Gérard Rancinan-Sygma; page 23: ILO.

Social Expenditure: Erosion or Evolution?

In the current debate over public expenditure, attention has focussed on the growth of social expenditures — the share of national resources which they consume, the effectiveness of their delivery and the tenets of social policy on which they are based.
OECD's Manpower and Social Affairs Committee has been looking into the question of how social expenditures can be controlled without causing irreparable damage to the social security and support systems that have been so carefully built up by the Western industrialised democracies since World War II.

Over the last twenty years, public expenditure on education, health, pensions and other income maintenance programmes in OECD countries has grown almost twice as fast as GDP, and has indeed dominated public expenditure growth. Since 1960, spending on these social programmes in the seven largest OECD countries has grown from roughly 14 per cent to more than 24 per cent of GDP (Chart A).

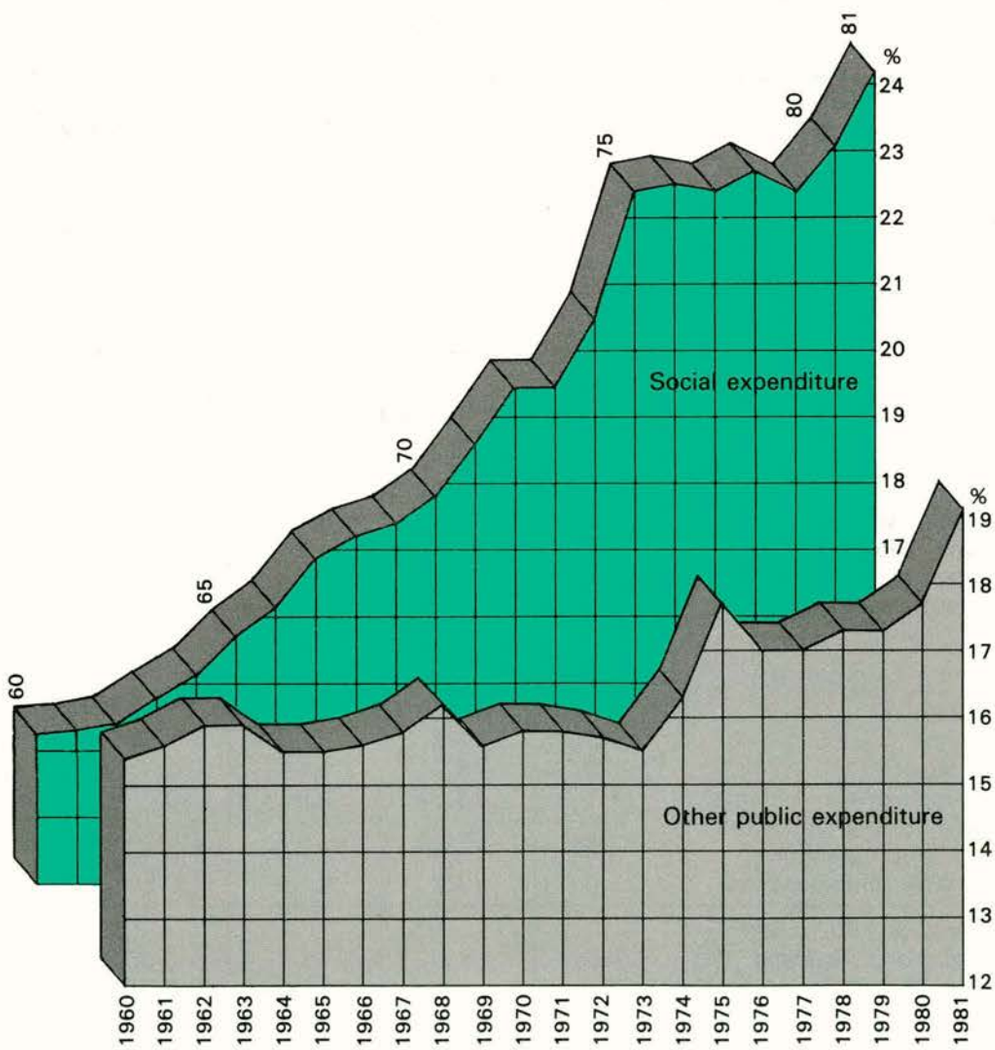
Some slowing down of this rapid growth was to be expected, but what could have been an acceptable evolution has instead assumed aspects of a financial crisis. Economic circumstances have forced an earlier, more severe and more urgent re-examination of social policies than would have been the case if high rates of economic growth had persisted and inflation been avoided. In the circumstances of the last eight years, economic and social objectives have been brought into conflict. Yet the social programmes of earlier years have acquired a momentum of their own, accelerated by the additional demands for social expenditure resulting from high and rising unemployment.

Pensions — The Biggest Item

Pension costs are by far the largest component of social expenditure. In 1981, pensions accounted for nearly 40 per cent of total social outlays, followed by expenditure on health care (23 per cent) and education (20 per cent) (Chart B). Unemployment insurance, by way of contrast, represents only slightly more than 5 per cent.

The expenditure pattern has been

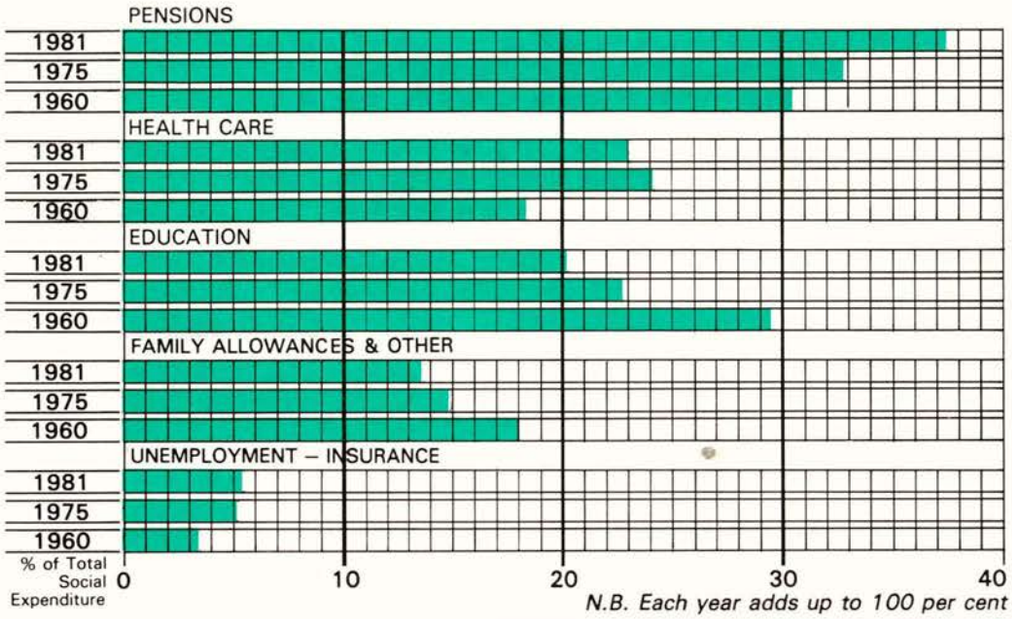
A. SOCIAL EXPENDITURE AND OTHER PUBLIC EXPENDITURE AS A PERCENTAGE OF GDP
(Averages for the seven major OECD countries)



Source: *OECD Secretariat and National Accounts*

B. THE CHANGING COMPOSITION OF SOCIAL EXPENDITURE 1960-1981

(Averages for the seven major OECD countries)



shifting over the last two decades. The main explosion in health expenditures occurred during the 1960s and early 1970s. In the years since the first oil crisis, however, health and education have borne the brunt of cuts in expenditure. Partly because the commitments are longer-term, expenditure on pensions has been more difficult to control: since 1975, the annual growth rate of old-age pensions has been as high as that of unemployment compensation.

The Forces at Work

Five main factors influence social expenditure: the number of people who could potentially benefit, largely a reflection of demographic changes; those actually receiving the benefit; the level of real benefits provided to each recipient; the overall price level; and the cost of particular services (health, education) compared to this general price level.

Up to 1975, social expenditures grew at an average rate of some 15 per cent a year in current prices (Table 1). Much of this growth was absorbed in the overall inflation of wages and prices, and some was lost – in real terms – because of cost increases in health and education that were greater than the rate of inflation. Real growth of social expenditure at about 8 per cent as against some 4 per cent for GDP was directed to coping with demographic changes and the larger number of unemployed and to broadening the coverage. But across the board, the main propellant of growth was the rapid increase in the real level of benefits – in education, health and social security. Together these increased in real terms by about 5 per cent a year – 1.5 percentage points above the real increase in private consumption per person.

Between 1975 and 1981, the patterns

1. GROWTH RATE OF SOCIAL EXPENDITURE 1960-1990

Averages for the 7 Major OECD Countries

	For reference: Social expenditure as a per cent of GDP	*Growth of social expenditure at current prices*	*Of which:*			*... due to:*		
			Change in overall price level	*Change in relative cost of welfare benefits*	*Increase in real social expenditure...*	*Change in demographic pattern*	*Change in coverage*	*Change in real benefit levels*
	1960	*Annual Change 1960-75 (%)*						
Education	4.2	14.7	5.4	2.57	6.1	0.29	1.90	3.83
Health	2.7	17.1	5.4	1.35	9.6	1.03	0.60	7.83
Pensions	4.5	14.3	5.4	0	8.4	2.23	1.62	4.35
Unemployment insurance	0.4	18.0	5.4	0	12.0	5.08	0	6.60
Family allowances and other programmes	2.5	14.0	5.4	0	8.2	n.a.	n.a.	n.a.
Total Social Expenditure	14.3	15.0	5.4	1.0	8.0	1.36	1.43	5.03
	1975	*Annual Change 1975-81 (%)*						
Education	5.1	12.9	9.65	1.14	1.8	–1.74	0.20	3.40
Health	5.1	14.2	9.65	1.02	3.1	0.26	0	3.10
Pensions	7.3	16.9	9.65	0	6.6	1.77	0.78	3.94
Unemployment insurance	1.1	16.7	9.65	0	6.4	7.84	–2.30	1.00
Family allowances and other programmes	3.4	13.4	9.65	0	3.4	n.a.	n.a.	n.a.
Total Social Expenditure	22.0	14.8	9.65	0.50	4.2	0.75	0.22	3.20
Scenarios 1982-1990								
"Optimistic" Scenario	*24.0*	*n.a.*	*n.a.*	*0.50*	*3.2*	*0.22*	*0*	*3.0*
"Pessimistic" Scenario	*24.0*	*n.a.*	*n.a.*	*0.50*	*2.3*	*0.56*	*0*	*1.7*

Optimistic scenario is based on a 3.7 per cent annual real GDP growth rate.
Pessimistic scenario is based on a 2.8 per cent annual real GDP growth rate.
n.a. not available.

2. SOCIAL EXPENDITURE BY COUNTRY, 1960-1981

	Social expenditure as a percentage of GDP		*Annual growth rate of real GDP*		*Annual growth rate of real social expenditure*	
	1960	*1981[a]*	*1960-75*	*1975-81[a]*	*1960-75*	*1975-81[a]*
United States	10.9	21.0	3.4	3.2	7.7	2.9
Japan	8.0	17.5	8.6	5.1	9.7	8.9
Germany	20.5	31.5	3.8	3.0	6.7	1.9
Canada	12.1	21.7	5.1	3.3	9.5	2.9
France[b]	13.4	23.8	5.0	2.8	7.4	7.6
Italy	16.5	29.1	4.6	3.2	7.4	3.1
United Kingdom	13.9	24.9	2.6	1.0	5.6	3.3
Australia	10.2	18.6	5.2	2.4	8.6	2.4
Austria	17.9	27.9	4.5	2.9	6.0	4.6
Belgium	17.0	38.0	4.5	3.0	9.1	4.6
Denmark	10.2	29.0	3.7	2.2	9.3	4.4
Finland	13.2	n.a.	4.5	2.9	7.3	n.a.
Greece	8.7	12.8	6.8	3.5	7.8	2.3
Ireland	11.7	27.1	4.3	3.5	8.2	5.2
Norway	11.7	27.1	4.3	4.1	9.5	5.6
Netherlands	16.3	36.1	4.5	2.0	9.2	1.4
New Zealand	13.0	19.6	4.0	0.4	4.4	3.7
Sweden	14.5	33.5	4.0	1.0	8.4	4.0
Switzerland	7.7	14.9	3.4	1.8	6.9	2.5

Notes:
a) Or latest available year. b) Excluding education expenditure.
Source: OECD Secretariat and National Accounts.
n.a.: not available.

of social expenditure changed. The rate of real growth was halved to just over 4 per cent, compared to not quite 3 per cent for GDP. But because the demographic needs were less and coverage was hardly extended, most of the real growth could still be channelled into further improvements in benefits to individuals. These increased by more than 3 per cent a year as compared with 2.5 per cent for private consumption per head.

Diversity Between Countries

The picture just described is based on average changes in the seven major OECD countries. Judging from available data, it does not change very much for the OECD area as a whole. But within the "average" experience, there is considerable diversity in the proportion of national product allocated to social expenditure (Table 2). The five countries with the highest ratios in 1981 – Belgium, the Netherlands Sweden, Germany and Italy – spent nearly 34 per cent of their GDP on social programmes. In contrast, the five countries with the lowest ratios – Greece, Switzerland, Japan, Australia and New Zealand – averaged just under 17 per cent of GDP.

Throughout the OECD area, the slowdown in economic growth since 1975 has been reflected in the slower growth of real social expenditure. In a few countries – notably Japan, Austria and New Zealand – the deceleration was modest. In Japan this is because the pension system is still expanding rapidly; in Austria because pensions loom large in total social expenditure; and in New Zealand because the pension system was significantly improved in the late 1970s.

And the Future?

With the emergence of economic recovery in the United States and a promising outlook in Japan, but with uncertain economic prospects for the European countries, it is difficult to predict the path of social expenditure growth during the rest of the decade. The OECD Secretariat has used two scenarios to set a framework for the analyses (Table 1).

The "pessimistic" scenario assumes that the slow economic growth since the mid-1970s will continue. The "optimistic" one assumes a moderate economic recovery. In the "pessimistic" scenario, productivity growth is assumed to pick up slightly, but the growth of GDP is assumed to be insufficient to reduce the rate of unemployment below its 1982 level of around 8 per cent. In the "optimistic" scenario, the unemployment rate by 1990 is nearly down to the 1975 figure (5.6 per cent), but productivity growth is still somewhat lower than in the 1960-75 period.

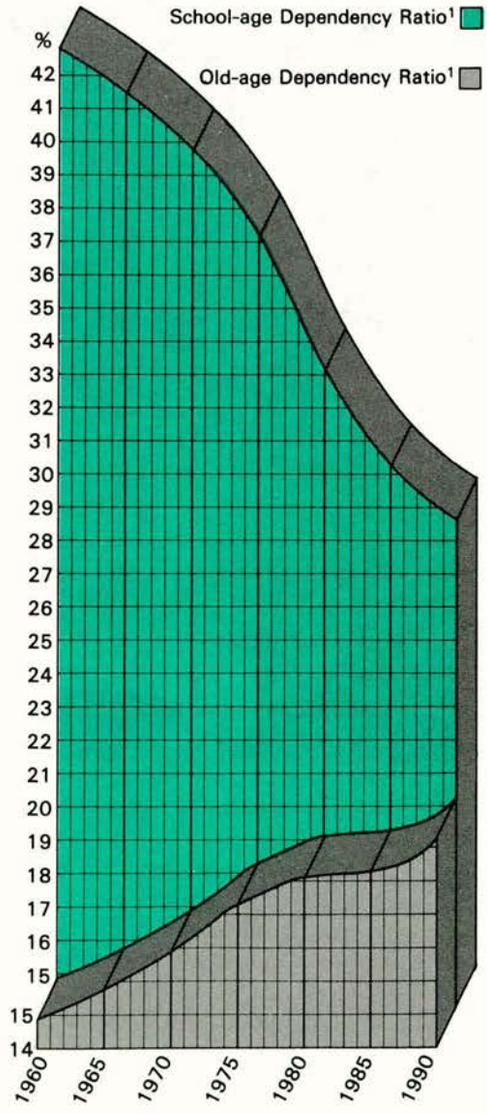
In 1981, social expenditure for the seven major OECD countries was 24 per cent of GDP on average. If this figure is held constant throughout the 1980s as the result of a deliberate policy decision, and if certain other assumptions are made, one can calculate how much benefits can rise in relation to the growth of GDP.

Broadly speaking, the conclusion that emerges from both scenarios is that during the remainder of this decade:

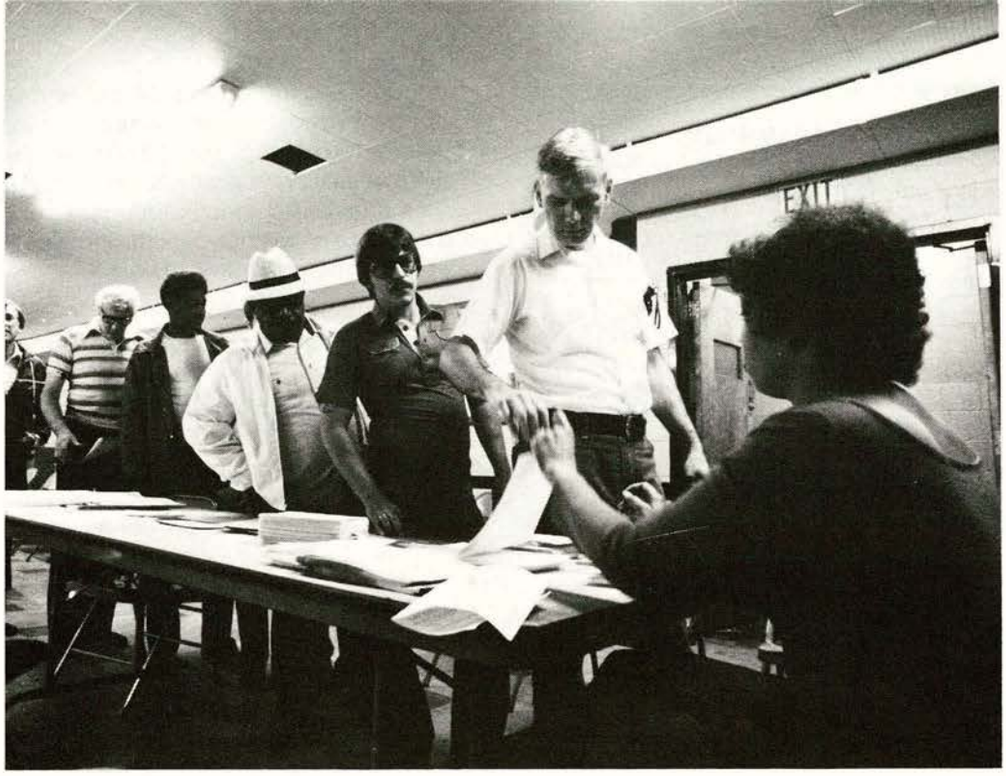
- *If* the demographic changes now predicted take place (Chart C)...
- *If* cost increases in health and education can be held to the overall rate of inflation plus one per cent (not an unreasonable objective)...
- *If* there are no further attempts to expand the coverage of social programmes...
- *Then* it should be possible for the level

C. CHANGES IN DEMOGRAPHIC STRUCTURE: 1960-90

(Averages for the seven major OECD countries)



1. The dependency ratio is the number of young people (0-14) or old people (65+) as a percentage of the population aged 15-64.



Unemployment insurance and pensions are the most rapidly growing items in social expenditure, but pensions are by far the largest in absolute terms while unemployment insurance is still the smallest.

of real benefits to grow at a rate similar to that of GDP.

Thus, under the assumptions of these scenarios, it is not likely that the Welfare State will need to be dismantled. During the coming years it should be possible to hold on to the gains in coverage and benefits made during the 1960s and 1970s and to improve on these approximately in step with, but no faster than, the growth of the economy. More rapid development of the social programmes will, as the scenarios indicate, require a faster rate of growth in the whole economy.

Emerging Needs

However, even with the "optimistic" scenario, it is difficult to foresee increases in the scope or coverage of any of the main social programmes. Yet there is likely to be pressure to do just that: indeed it is unrealistic to imagine that there will be no further demands on social programmes. OECD countries have been facing a new range of challenges since the mid-1970s, and it is reasonable to expect that people who have become increasingly reliant on the Welfare State will look to it when faced with new difficulties of unemployment, family income, retirement and other social needs.

The emerging demands on the welfare system have not yet been quantified or even clearly defined. One thing is clear, however: a number of them will be associated with the difficulties individuals find in obtaining security and support from the labour market. The ageing population and changing family and life-cycle patterns will also make greater demands on the social system.

The financial implications of the emerging demands in the next few years are not likely to be large in terms of total national budgets, but they may become more expensive later on, and even modest increases in the social budget would disrupt the balance suggested by the two scenarios.

In the longer term (beyond 1990), the principal challenge facing social welfare systems may be to accommodate the demands on the social budget of an ageing population. An increase in the proportion of old people in the population not only requires higher pension transfers; it also places heavy demands on the health system. A current OECD study on health expenditure reveals the significance of the relationship between age and the "consumption" of health services. Moreover, disappearance of the extended family and the influx of women into the working world mean that older people, deprived of the "services" provided by the family, come to rely on the State. The continued political thrust for equality of treatment between men and women will also exert pressure on governments to improve the social security coverage of women. For example, if years spent in raising a family were to be counted, retirement benefits for men and women would be more equal at retirement age.

Other changes in family structure will also make a call on social expenditure: the rise in divorce rates, longer life expectancy, and more one-parent families mean more family units having little or no income from employment. Since these trends are unlikely to be reversed, further demands on public welfare programmes seem inevitable.

If as a result of all these needs there is a demand for more or new benefits or extended coverage, social expenditures must be increased relative to GDP or funds must be directed from lower to higher priority programmes. Whatever the choice, there will be a need for a more efficient management of social services and a more effective organisation of the Welfare State. Here lies the central challenge to social development in the OECD countries.

Technological Innovation: Key to Progress in Less-Industrialised Countries

Can the new technologies ignite more rapid development in the less-industrialised countries? Or are they more likely to widen the gap with the advanced economies which can use their industrial base as a springboard to launch themselves into what is being termed the third industrial revolution?
These questions were at the heart of the discussion at a recent OECD workshop in Dubrovnik where experts from the less-industrialised OECD countries[1] met with those of several highly industrialised nations to discuss technological innovation[2]. The object was to identify the factors that have held the less-industrialised countries back and to search for some alternative to the path taken by the wealthier nations – one which would be better suited to their socio-cultural and economic structures. The fact that the industrialised countries have the same type of problems as the less-industrialised ones when it comes to technological innovation – though to a lesser degree – was one of the striking facts that emerged from the Dubrovnik workshop.

Different though they are, Greece, Portugal, Turkey, Yugoslavia[3], and to some extent other countries at an intermediate stage of industrialisation, share a number of characteristics. Their economies are still heavily agricultural, and this means a dispersed society in which small units are the social and economic norm, even outside of agriculture: local industry is usually made up of small, often family-owned businesses, very much under the sway of a single entrepreneur. Such a pattern constitutes an industrial base but one quite different from that of the highly industrialised countries which, to some extent at least, are integrated into the international economy. These economies are in effect still going through the second industrial revolution in which labour-intensive production is replaced by capital-intensive activities. This, together with a series of other factors, has created endogenous unemployment which for decades has driven the population to emigrate, despite the absorption of many potential immigrants by agriculture. But in the wake of the recession in the host countries, the period of massive emigration came to an end, exacerbating the problem of unemployment.

Another characteristic which the less-industrialised countries share is the low level of general education. One sign of this is Portugal's official statistics, which record the unemployed as from the age of 10. As for the system's traditional bias towards the humanities, the less-industrialised countries are not the only ones to have it.

Because of these factors, the less-industrialised countries are concerned, especially in view of the recession, with the challenge of the new technologies which, it is generally agreed, are unsettling even the most solidly based economies.

Can The Handicaps be Turned to Advantage?

Some features of the economies whose technology and industry have not yet been modernised are handicaps; others might be turned to advantage under the leadership of motivated people with a belief in the untapped development potential of their countries. For example, the humanist bias of the educational system may constitute a form of capital which the new technologies could put to advantage. It provides an ability to communicate and the sense of belonging to a culture with historical traditions that can evolve.

One question must be answered if the past is to make way for the future: why has traditional industry not taken hold in those countries to the same extent as elsewhere? It may be because their structures were unsuited to the purpose; because large organisations were imposed on a rural village structure consisting of multitudes of small units. Contrary to the experience of the highly industrialised countries, where the economy and society have evolved towards industrialisation over a long period of time, the structural changes that have taken place in the less-industrialised societies have not, whatever the explanation, created a modern industrial base capable of competing internationally. The question is whether a society of this type may not be more receptive to the new technologies

1. *Those OECD countries which are called less-industrialised are by no means an official or even clearly defined "grouping". However their level of development compared to that of other Member countries (whether measured by GDP per inhabitant, employment in agriculture, outlay for R & D or for aid to the Third World) means that OECD gives them special attention in the form of directly operational activities in public administration, rural development and industrial adaptation.*

2. *The workshop was entitled* Policies of Technological Innovation in the Less-Industrialised OECD Countries. *Those who participated – representing 15 OECD countries in all – were national, regional and local administrators of agencies concerned with innovation and scientific and technological development, entrepreneurs, researchers and bankers.*

3. *Yugoslavia is not a member of OECD but has a special status within the Organisation.*

which, by their very nature, can be used in a decentralised way that is in keeping with the country's "natural" structures. The trend now emerging towards smaller units capable of giving greater scope for individual initiative – and hence more hospitable to innovation – seems to point in this direction. So does the changing role of the entrepreneur who today must be not only a technician familiar with markets, especially foreign ones, but must have a broader background from which the humanist element is by no means absent: he must be able to develop human as well as material resources and to demonstrate capacity for leadership.

The possibility that there may be a mutual receptiveness between the social and economic fabric of the less-industrialised countries and the new technologies is a key point. If the hypothesis were proved correct, it might mean that these countries could "skip a step", to bypass the kind of industrialisation that is based on massive capital investment and heavy equipment and to draw directly on what the new technologies have to offer. If so, they might also be able to bypass many painful problems facing the highly industrialised countries due to the need for conversion of traditional industries in many sectors.

Intermediate cases

Spain, which was much discussed during the workshop and is midway between the two groups, is an interesting case in point. Partly identified with the less-industrialised countries, with which it undeniably shares many features, Spain nonetheless has a traditional industrial base which makes it more like the highly industrialised nations. However, its industries are largely in problem sectors (shipbuilding, iron and steel) and the Spanish Government, seeking to adapt to the new economic circumstances, has introduced radical measures of structural adjustment. Would it be possible to take advantage of this situation to launch into a new type of industrial development?

The Spanish Delegation to the workshop regarded structural adjustment as a difficult and painful process and one the country could well have done without. At the same time, it has provided a pool of skilled or semi-skilled labour with industrial experience and, in theory at least, free to try something else. Yet that work force – and with it the entire population of the region – is discouraged: there is a lack of initiative and of the courage to acquire the knowledge and skills required to embark on the adventure of new technology. Combatting this discouragement is one of the aims of the Centre for Industrial and Technological Development from which both the Spanish delegates came. It can be done, to judge from the results achieved by the model in this field, the Shannon Development Authority in Ireland (see inset) whose approach could usefully inform other experiments.

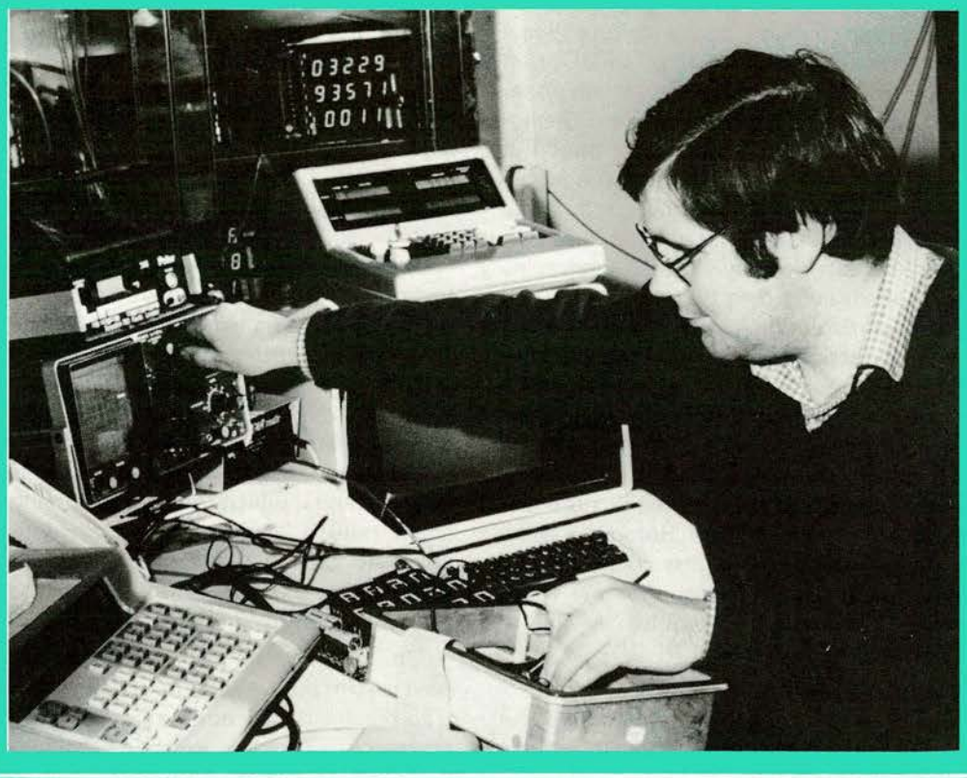
Some delegates, in particular those from Turkey and Yugoslavia, acknowledged the difficulties of structural adjustment but stressed the importance of the traditional sectors in supplying the "critical mass" of laboratories, professional skills and brainpower – the density of innovative capacity – necessary for a technological take-off. They cited the pioneering role played by the motor industry in robotics and pointed out more generally that certain traditional sectors are now highly technology-intensive. But the very definition of critical mass may have changed with the advent of the new technologies. Indeed the capacity for innovation exists in the less-industrialised countries, but dispersed rather than concentrated. With the new technologies – computers and telecommunications in particular – even the small unit can have access to information and hence acquire the management and conceptual capacity it has lacked until now.

A crucial point in this context is the role of technology transfer. A delegate from Ireland forcefully argued for the necessity of a national base of technological skills while others, though not denying the validity of such an approach, gave more weight to the value of spin-off from foreign firms established in the less-industrialised countries. Though by definition hard to gauge and often the result of the firm's internal needs, such spin-off is far from negligible, and a country striving to adapt

THE SHANNON DEVELOPMENT AUTHORITY

Among the agencies responsible for promoting innovation and new firms, the Shannon Development Authority is often cited as a model. The five main factors in its success seem broadly applicable to other agencies of this kind:

- The Authority is autonomous, even though the government has representatives in its executive bodies.
- Its activity is not confined to a given sector: innovation is trans-sectoral by definition, and promising opportunities need to be seized whatever their origin.
- The Authority is not obliged to follow a set procedure. It may provide firms with financial assistance, or become involved in training, research, technical assistance or any other activity it thinks appropriate.
- It has a team of field workers who go into firms to see what is needed, and feed the information back to the Authority.
- Its aim is clear: to create entrepreneurs, and an entrepreneurial environment, in a limited geographical area.



Traditional industries may serve as a base for innovation and the mastery of new technologies. Above: Artisanal weaving in Greece.

its structures should have no false pride about benefitting from it. In any case, the less-industrialised countries will continue to depend on technology from abroad to varying degrees. Whether they use it deliberately to build up a national technology base, or continue to depend on other countries for some things, they need to strengthen their capacity to absorb technology, if only so that they can import the technology that is right for them.

The role of returning migrants

What role can returning migrants play in the process of technology transfer? First of all, it is a fact, though often overlooked, that migrants fall into two categories. Attention generally focuses on manual workers who, at best, return home with a degree of training, some familiarity with industry, ideas, and money which they wish to invest. This potentially rich amalgam needs to be turned into something more constructive than the traditional purchases of a house (see page 11) both for the good of the country and that of the individuals concerned.

But there is another type of migrant – the highly qualified engineers, scientists and other professionals who while abroad have acquired not only a knowledge of the technological state of the art, but also a sense of timing about when to use the new technologies to tap innovative potential in their country. Yet the highly qualified migrants find it even more difficult to return home than the manual workers. Those who try – and there are not many – face not only financial problems (the dramatic fall in living standards) but professional ones as well – inadequate infrastructure, administrative obstacles, the hostility of peers, etc. Yet the less-industrialised countries consider it essential that these migrants return home and join with other highly motivated and enthusiastic people in a kind of human network, which can serve as a very effective spark to development. It is urgent that the problems of these highly qualified people be examined so that their return home can be facilitated.

Needed Reforms

The educational bottleneck...

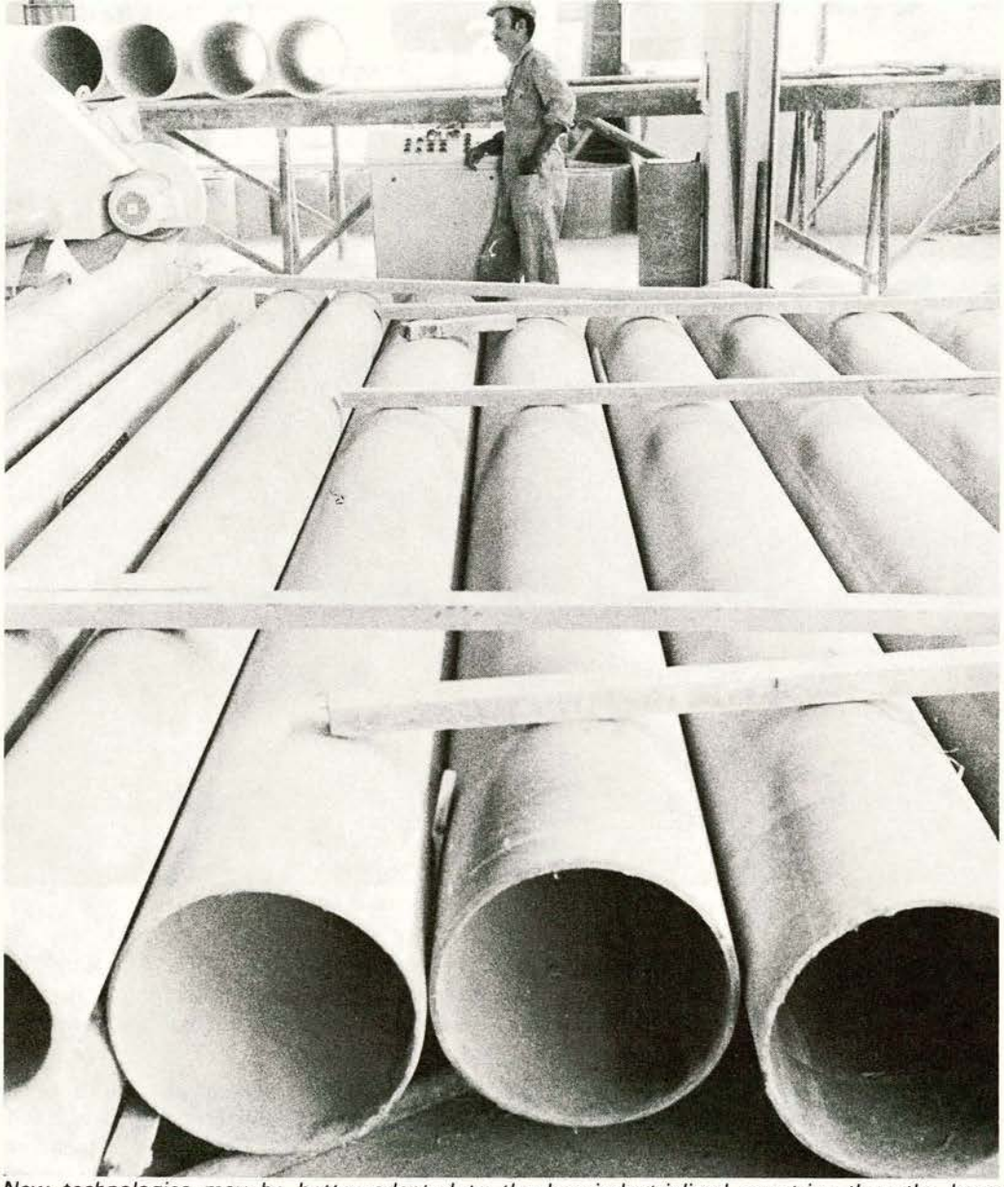
The educational systems of the less-industrialised countries hardly encourage the inhabitants of these countries to embark on an innovative path. Nor does it train them to follow through – to take the risks involved in setting up a new firm, for example.

But how can the educational system be made more conducive to innovation? One approach would be to decentralise – to allow the individual school, which is in direct touch with local needs and sensitivities, to determine its own curriculum. Since the schooling could be geared to solving local problems, it would be conducive to innovation but would imply adding new subjects to the curriculum. The problem is how to fit these in with the academic courses required both to maintain the country's cultural level and to create an intellectual elite. Although this problem was discussed at length, no way was found to resolve such conflicts without further research.

Another approach would be to begin developing what the French call a "technical culture" – the integration of technical knowledge into the general culture of the population. At present there is a lack of historical countinuity linking past to present in the matter of technical knowledge. For example young students may be familiar with the way the pyramids were built or the appearance of the first motorcars at the turn of the century but have no idea what a 1950s tape recorder looked like. Establishing this link, which is essential for innovation, could start with the creation of technological museums, special exhibits and the like so that people become familiar with technical objects. This would stimulate them to move on to more specific knowledge – of materials and computer techniques for example – which could stimulate the imagination and perhaps eventually lead to the creation of an entrepreneurial mentality. An example of such a progression was given by a delegate from Ireland where secondary students have created and are managing mini-firms that actually produce – and sell – products.

...and the bureaucratic one

By far the most general complaint at the Dubrovnik workshop focused on the bureaucratic hydra which, with its inertia and inflexibility has an impressive capacity to block progress in the less-industrialised



New technologies may be better adapted to the less-industrialised countries then the large capital-intensive firms typical of the second industrial revolution. Above: A cement plant in Portugal. *The development of technical culture implies on-the-job training.* Below: Yugoslavia.

countries. How can this bottleneck be eliminated? One approach would be to set up from scratch a new governmental department with special responsibility for promoting innovation. There is a danger, though, that this will simply add more heads to the hydra. A second approach would be to seed all government departments with the kind of people who are receptive to innovation and can communicate their enthusiasm to the others. But the option that was most favoured at Dubrovnik was the idea of a compact, mobile (and non self-perpetuating) unit, as independent as possible from the rest of government but able to influence its actions and to convey the "message" of innovation to every key point in the government.

Since, at least for a time, the public authorities will have an essential role to play in promoting innovation, the problem of public management is not only one of finance, especially if risk capital is to take over from government funds; it is also important for the administrative superstructure to be flexible from the start and to respond to change in innovative ways.

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The less-industrialised countries are convinced that adequately targeted information, closely attuned to their particular requirements – what is called "front-line information" – is the key to narrowing the knowledge gap with the more industrialised countries in social, economic and technical matters and hence to keep from falling still further behind them. But such information is rarely available and, when it is, comes only in "code" – that is to say it is so general, abstract and sophisticated that only high-level "code breakers" can make it of practical use to others. And less-industrialised countries do not have these code breakers, or at least not in sufficient numbers.

The representatives of the less-industrialised countries called for international organisations to play a greater – and perhaps different – role in providing impartial expertise. A Portugese delegate went so far as to say that, if these organisations could supply decoded information on the special economic, social and political problems of each country, it would not only reveal the urgency of immediate action, but could help create a "culture shock" that might shake off even the most entrenched institutional inertia. The delegates proposed to open the doors of their institutes, laboratories and firms and to share their experiences, both positive and negative, so as to help other countries avoid the numerous pitfalls that a reorientation of development policies towards more innovation implies.

How Can Migrants be Involved in Industrial Development?

Throughout the period of large-scale emigration (roughly 1960-1975), the combination of savings (in the form of migrants' remittances) and labour (returning migrants who had acquired relevant skills) were expected to initiate the process of industrial development almost automatically, or at least with the help of appropriate governmental policies. Economic and industrial cooperation on the part of the receiving countries could also contribute.
But it seems that international migration has made only a very modest contribution to industrial and technological development in the countries of emigration. This may be because the expectations were unrealistic from the outset or because political and administrative obstacles have blocked mobilisation of potentially available resources.

Despite the worsening economic conditions in immigration countries, the return flow of migrants has been slow and relatively stable as compared to new entries or as a percentage of foreign resident populations. The main reason seems to be that they are staying abroad longer: in most receiving countries, more than half the foreign residents have been there for ten years or more.

Although workers' remittances have helped to right imbalances in international payments of certain countries, management of these sums – the result of millions of individual decisions – poses intricate problems, both legal and economic. Especially at the regional and local levels, where the funds ultimately go, the problem is whether they are to be used for consumption or investment and how they will be divided among localities, regions and national governments. The considerable research that has been carried out on these questions in recent years indicates that, as might be expected with workers' individual savings, the largest share is used to improve standards of living; some are used to repay loans and some put into bank accounts or used for the purchase of real estate. Only a small portion is invested in firms[1]. There are obstacles to the investment of private savings in these countries including:

- the lack of effective governmental policies to promote such investment
- the paucity of concrete investment opportunities in emigration regions
- the lack of entrepreneurial or managerial capacity on the part of those workers who would in principle be willing to invest
- the weakness of contacts between entrepreneurs and expatriate savers.

Programmes to Encourage Migrant Firms

Programmes set up by governments of labour-exporting countries since the early Seventies to promote the social and economic reintegration of returning migrant workers have two elements:

- to attract and productively invest migrant workers' savings
- to adapt the skills of migrant workers to the needs of national labour markets.

Bilateral programmes launched by countries of immigration for workers willing to return to their country of origin feature special vocational training and financial assistance, sometimes specifically aimed at the creation of small and medium-scale enterprises.

To date, there is no comprehensive summary of the results of national and international programmes, but there are some signs of how they are going.

- *The German/Turkish programme,* launched ten years ago, has resulted in the creation of 200 migrant worker companies of which 100 have reached the production stage. Some 237,000 workers are reported to be shareholders and an estimated 12,000 jobs have been created.
- *The Dutch programme* has led to substantial financial and technical assistance for three major industrial projects in Portugal, five in Yugoslavia, six in Turkey, and roughly the same number in Tunisia and Morocco. Financial means at the disposal of these projects ranged from 500,000 to 3,000,000 guilders apiece. Another programme – called a return migration project – has handled 1,200 proposals, for the creation of small firms since 1975, 200 of which have been approved, 400 more being in the preparation stage. It is estimated that each project has a maximum aid component of 100,000 guilders and creates five jobs.

Acquired Experience

What have been the effects of these economic initiatives on the development of the regions in which they take place? The few published reports indicate that, apart from the programmes mentioned above, migrant workers' initiatives in the countryside tend to focus on modernising agricultural units already belonging to the family and, in urban centres, on small artisanal activities, repair shops and minor services.

In certain cases these activities have had some counterproductive effects: in *agriculture* the large supply of private capital, combined with a stagnant supply of other production factors (economic and technological information, modern trained agricultural personnel) has created bottlenecks. There has sometimes been overmechanisation without modernisation of management or industrialisation of production or storage of agricultural products. Moreover, the influx of migrants' families has entailed speculation in rural real estate so that farmers have not been able to enlarge their holdings at normal prices.

In *urban centres,* the same type of process can be observed. Although a wide range of activities has been affected by the availability of new private capital (textiles, leather, light metals, plastics, and transformation of agricultural products), the dominant picture is that of a "static" expansion – more firms producing the same product for the same markets, with the same technologies within the same type of

1. A meeting of government experts sponsored by OECD's Technical Cooperation Service and its Social Affairs, Manpower and Education Directorate is scheduled to discuss the role of financial institutions in this process in Izmir, Turkey, during the month of January.

economic structure. In the absence of alternatives, entrepreneurs tend to copy successful existing enterprises.

In the sphere of *financial services,* no qualitative changes have occurred. Traditional savings banks draw upon larger local resources but still invest them elsewhere, while informal financial brokership flourishes. The middleman has been the main beneficiary of the influx of fresh capital.

Despite these problems, the programmes have a number of positive elements in common:

- International labour migration has given rise to industrial investment in regions where such investment is normally rare and has created at least some new entrepreneurial activities.
- Private savings have been used for such investments.
- International concertation on migratory flows has led to new cooperative programmes for the economic and industrial development of less-industrialised regions.

The advantages and drawbacks of these experiences have begun to attract the attention of governments and to affect the action taken. There is, for example, more concern with the identification of specific possibilities for industrial development in the regions concerned and the obstacles likely to be met.

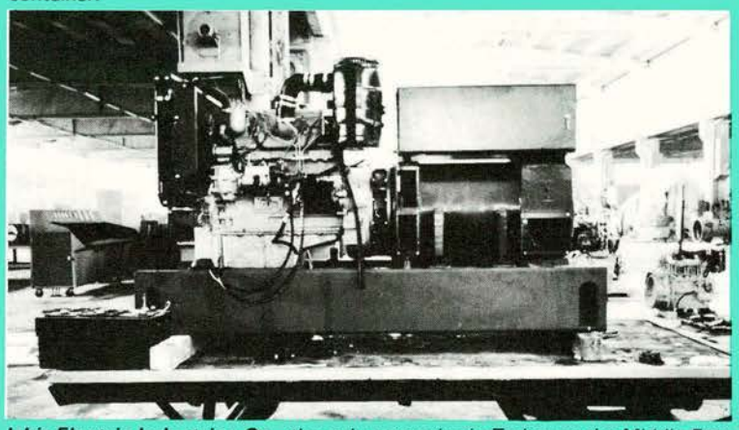
The promotion of technological progress in emigration countries through the mobilisation of the human and financial resources represented by migrant workers seems to necessitate a change in orientation:

- An emigration region should be reviewed in terms of its economic development potential and especially its investment climate.
- Migrant workers should be viewed as a special kind of private saver who could become an entrepreneur or provide other qualifications to the local labour market.
- Enterprises set up by migrant workers should be treated as just another kind of small and medium-scale enterprise, with the same problems (except for the availability of substantial private capital), and to a large extent the same risks.

ISBIR HOLDING – A SUCCESSFUL INITIATIVE

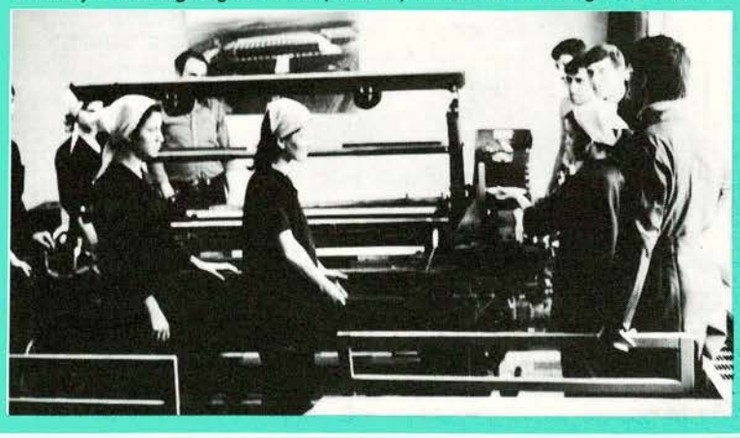
At the end of the Sixties, some Turkish immigrants working near Cologne in Germany began travelling around the region to collect small sums saved by their fellow countrymen, with the aim of founding a migrant firm back in Turkey. Now Isbir Holding has 3,700 shareholders, half of them still working abroad and some 10 firms employing 700 workers, many of them migrants who have returned to Turkey; half the directors are also former migrant workers. Half the profits are distributed to the shareholders, the other half invested. About a third of the production is exported, mainly to the Middle East. To diversify its portfolio, Isbir Holding has recently invested a small portion of its profits in non-industrial holdings.

Isbir Synthetic Weaving Industries Co. *is the largest Turkish firm in that industry (30 per cent of the national market).* Above: a one-ton polypropylene container.



Isbir Electric Industries Co., *the only enterprise in Turkey or the Middle East which manufactures synchronous alternators. Eighty-three per cent of the parts are locally made.*

(Above): ***Isbir Temoptic Industries,*** *the first firm manufacturing eyeglasses and other optical equipment will begin operations in February of 1984.* (Below): *On-the-job training is given an important place in Isbir Holding's activities.*



The Obstacles to International Trade in Services

International trade in services[1], an essential adjunct to commerce in raw materials and manufactured goods, has become an increasingly important factor in world trade. But although services have been included in postwar trade liberalisation from the outset[2], many restrictions remain[3].

Given the growing importance of the third or service sector, Member countries have tried to identify and evaluate obstacles to trade in this field so as to work towards the removal of unjustified impediments and better international cooperation in this area.

In the context of this work, OECD will focus on several important service sectors. The first in a series of studies covers insurance[4], and a report on tourism will be issued shortly[5].

Insurance...

International insurance activities may take the form of *international rendering of services,* analogous to international trade in goods, or *services provided by subsidiaries or branches of foreign insurers established in a given country.* The second type is more important in the insurance industry, and probably in other service sectors than in manufacturing: generally a foreign concern must be established in the country concerned if it is to be competitive in that market.

Establishment

OECD has found that the most serious of the numerous obstacles to international insurance is in the matter of establishment. A prerequisite of all pursuit of business is the initial authorisation to "establish" or participate in a market. If this authorisation is refused or there is a delay in responding to an application for a licence on the part of a non-established foreign insurer (or an established insurer wishing to extend its activities to new types of insurance), this obviously constitutes a barrier to trade. Other restrictions on the opportunities of a foreign insurer – prohibiting the company from performing certain services or delaying authorisation until domestic insurers are ready to provide it themselves – can have the same result, even if they do not constitute a formal obstacle to authorisation.

In some instances insurance firms have encountered difficulties in establishing branches – the form of establishment most favoured by insurers – or subsidiaries, the form favoured when a branch is prohibited or made subject to special conditions. There may be across-the-board limitations so that it is impossible to obtain a licence to establish any type of insurance operation or the restrictions may affect only particular classes of insurance.

Operational Terms

The second most serious category of obstacles involve the terms under which a foreign company must operate; and these in turn directly affect a firm's ability to compete on an equal basis with domestic companies.

Differential treatment of foreign and national firms can also affect competitiveness. Often foreign firms are submitted to more stringent financial rules than domestic companies – in the lodging of statutory deposits, the investment of funds and other particulars.

Discriminatory fiscal measures can also have an impact on the profitability of a foreign insurer's operations and hence on his ability to compete. The same is true of government procurement practices which favour domestic over foreign insurers. The relationship between direct purchases of insurance by governments and other insurance activities may be more complex than the rules and regulations indicate. Thus, if there are preferential procurement policies, foreign insurers may be excluded from the chance to compete for a whole range of insurance opportunities associated with governmental activities.

Finally, recruitment requirements, particularly for managerial staff, may present an obstacle to foreign insurers seeking to set up a subsidiary or branch.

Freedom of Insurance Transactions

The third important group of obstacles are those which interfere with the freedom of insurance transactions when an insurer has not established a subsidiary or branch in the country concerned. Even the two types of insurance which by their nature and history could be expected to be free – insurance of internationally traded goods

1. *Commercial services between countries and services furnished by foreign companies on national markets. The service sector includes insurance, banking, transportation, communications, software, tourism, construction and engineering, retail trade, franchising, advertising, accounting, legal services, health, education, etc.*

2. *In OECD's Convention and in its Code of Liberalisation of Current Invisible Operations. This code is now being revised.*

3. *Some of these affect "liberalised" operations under the Code and the position of the countries which apply them are covered by "reservations" recorded in the Code; other restrictions are applied in areas which fall outside the scope of the Code.*

4. Trade in International Services: Insurance, *OECD, 1983.*

5. Obstacles to International Tourism in the OECD Area *available from OECD's Directorate of Financial, Fiscal and Enterprise Affairs, Tourism Section.*

and reinsurance – are still subject to certain restrictions in some Member countries.

Outright prohibition of insurance transactions with non-established insurers is less common than other practices which present obstacles to the freedom of insurance transactions. Discriminating fiscal measures are of special concern since they can discourage purchasers from buying insurance from a foreign company which has no licence, even if such a transaction is theoretically permitted. Placing a heavier tax burden on a non-established company has the same effect as giving tax relief only to subscribers who purchase insurance on the domestic market: it discourages buying insurance abroad.

Even the insurance of internationally traded goods, which might be expected to be free, is subject to restrictions.

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What obstacles, created by governmental or quasi-governmental action, distort international tourist flows within the OECD area? The inventory just made by OECD's Tourism Committee – by no means a comprehensive one – is based on two main principles. First, the ability to travel from one country to another, for business or pleasure, should be considered as a right and not a privilege. Tourism has grown to such an extent that it can no longer be regarded as a luxury but as an essential part of present-day society in which leisure is more and more important. Second, the provision of services to the tourist – before departure, while travelling and after arrival – should be governed by the normal rules of commercial competition. As a result, any measure which sets up barriers to the normal competitive activities or which works to the advantage of the nationals (or national firms) of one country over those of another should be regarded as a trade barrier, even if it does not prevent the tourist from travelling abroad.

Among the obstacles identified by the Tourism Committee, some are clearly discriminatory – visa requirements, restrictions on taking currency in and out, and formalities of all kinds – since even if they do not prevent travel, they act as a deterrent to it. Other measures are often considered not to be discriminatory because they are applied to nationals and foreigners alike – most airport taxes for example. However, to the extent that they deter nationals from travelling abroad, they discriminate against the tourist industry of other countries and favour tourist facilities in the home country.

Obstacles to... Individual Travellers

Visas and passports. While only two OECD Members – Australia and the United States – require visas for the nationals of all other Member countries[1], more and more countries require "selective" visas, for certain nationals only. To justify such practices, immigration and employment considerations are usually put forward, but OECD's report stresses the necessity of maintaining a clear distinction between these two problems and that of international tourism.

The entry of tourists should be subject to as few requirements and formalities as

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possible in OECD Member countries. If visas are deemed necessary in particular circumstances, they should be easy for the tourist to obtain and as inexpensive as possible.

Foreign travel allowances. Fifteen Member countries impose exchange restrictions (on foreign currency and national bank notes) on residents who want to travel abroad. Almost all respect the 750 unit-of-account minimum fixed by OECD's Code of Liberalisation of Current Invisible Operations[2]. The Tourism Committee felt, however, that this sum, established some 20 years ago, no longer fits today's needs: a new figure should be fixed, and the minimum should be supplemented by a system of automatic indexation. The revision should also take into account the use of credit cards. The distinction between travel for business and travel for pleasure should be abolished.

In fact, OECD's report considers the term "allowance" to be misleading since it implies that access to foreign travel is a privilege rather than a right: a situation is "normal" only if there are no restrictions on the amount of foreign currency or other means of payment that a *bona fide* traveller may take out of the country, although he may reasonably be asked to justify the purpose of his travel. Where it is found necessary, for balance-of-payments reasons, to limit this amount, the limitation should be regarded as temporary and for a specified duration.

Special taxes on international travellers. Such taxes are growing in importance: eight countries have them, mainly in order to obtain additional revenue. The significance of such obstacles depends on what rate is applied, but in any case they cause substantial disruption.

Duty-free allowances. This is an obstacle because of the complexity and confusion it creates, since the rules vary with the destination and the origin of the traveller. The allowances should, as a matter of principle, be as liberal as possible, provided the goods are for personal use (or gifts) and not to be resold. The rules should be uniform.

...Travel Organisations

Apart from economy-wide problems such as the right of establishment, access to markets and national treatment, the treatment of travel organisations (other than transportation firms which are considered separately) involves certain aspects of the tourist industry itself: advertising, for example, and the search for prospective customers, transfer of capital, dividends and fees. Obstacles to this sort of transfer may increase the number of middlemen, and, by excluding foreign competition, may also raise prices for the traveller.

Restrictions on employment. A number of restrictions involve employment, but the matter is a delicate one, like that of selective visas since it reflects national immigration and employment policies. It appears however that there could be further liberalisation for trainees and other foreign personnel who will be working abroad for only a specified period of time.

...and Transportation

Efforts are being made to resolve problems in the field of road and railway travel, but OECD's report focusses on air transport, without which tourism cannot conceivably realize its potential.

The air transport industry has four special characteristics:

- It is based on international conventions which give rise to bilateral negotiations involving the granting of reciprocal rights.
- It is a monopolistic or oligopolistic industry often composed of governmental or quasi-governmental entities.
- It is often treated like a public utility.
- It is important to national security.

It would be inappropriate for OECD's Tourism Committee to go into the rights and wrongs of the air transport industry's structure. It can only notify the appropriate authorities that certain barriers constitute discrimination against foreign transportation companies and can therefore harm the international tourist industry. Examples are: advertising, access to reservation systems, assignment of ground-handling facilities and airports, and differential landing fees.

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Having made this inventory of trade barriers, OECD's Tourism Committee will examine the possibility of action within the OECD, including reinforcement of its Code of Liberalisation, to encourage the simplification of formalities and the liberalisation of other matters which have been shown to represent barriers to international tourism. It will also introduce a system to review and appraise such action so as to fight the rise of protectionism.

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1. The United States makes an exception for Canada, and Australia for New Zealand.

2. 1 unit of account = 1 SDR or approximately $1.05. Generally no restrictions are imposed on business travel.

Control of Mergers

Merger control has become an integral part of competition policy in the OECD area. At the end of 1972, only four countries had specific measures for investigation and control of mergers – Canada, Japan, the United Kingdom and the United States. The European Community also had legislative provisions to prevent mergers that would diminish competition in steel. In the last decade, six more countries have adopted such controls – Australia, France, Germany, Ireland, New Zealand and Sweden.

The number of mergers reached a peak in the 1970s, and many of the laws were passed at that time. Since then, the number has declined and then turned up again, and the number of very large mergers is on the rise[1]. Of the three broad categories of mergers – horizontal, vertical and conglomerate – horizontal mergers have predominated in all countries except Japan and the United States where conglomerate mergers figure large, but vertical and conglomerate mergers are on the upswing in all countries except Sweden. Sectors with the most merger activity are the distribution and service industries while manufacturing activity has declined. Increasing numbers of mergers involve foreign companies.

Firms try to acquire other, usually smaller, firms for a variety of reasons:

- to increase market power
- to diversify so as to spread risks
- to achieve economies of scale or greater financial strength
- to reap the profits associated with a merger transaction or to obtain tax advantages.

In addition, there are human factors: company managers may want to increase their empires, for example.

From a broader point of view, the impact may be beneficial since mergers – even very large ones – may increase competition and provide economies of production (or distribution) and incite greater technical progressiveness. But the potentially negative effects have been the primary focus of recent concern: the increased concentration resulting from mergers may be detrimental to competition, prices and efficiency. And questions have been raised about the economic benefits of mergers.

The desirability of a merger may be judged differently in one country than in another, but there are two basic approaches: one is to focus on competition as the sole criterion of acceptability. In many countries, a finding that competition would be reduced is enough to make the merger unacceptable.

The other – and broader – approach is to ask whether or not the merger is in the public interest. Such a criterion takes into account possible social and economic effects as well as the impact on competition in determining whether a merger should or should not be allowed.

As to the effect on competition, most countries have adopted quantitative thresholds to determine whether or not a merger falls within the provisions for control. The threshold may be expressed in terms of market share or absolute size – assets, sales, turnover or employment. An important element in this context is the definition of the relevant product and geographical market in which to measure the effect on competition.

Since annulling a merger once it is a *fait accompli* can be disruptive to the firms involved and to the economy, some countries have drawn up guidelines that enable companies contemplating merger to know in advance whether or not their action is likely to be challenged. Recent guidelines of the United States Department of Justice spell out what types of mergers will be challenged and provide a quantitative measure of undesirable levels of concentration – the so-called Herfindahl-Hirschman index[2]. In addition most countries have a system of pre-merger notification which allows the competition authorities to offer their views on the legality of the merger before it takes place.

One of the most important recent developments in the field of mergers is the attention devoted to the acquisition by a large firm of a small one in an industry characterised by the presence of competitive small and medium-sized firms. In this context it is interesting to note provisions recently adopted in Germany to control acquisitions of small firms by large ones with sales of DM 2 billion or more, and a 1977 amendment to the Japanese Monopoly Act which was mainly designed to restrict overall shareholdings in other firms by large companies.

OECD's report concludes by offering suggestions, based on experience to date, for countries planning to introduce or amend their merger control provisions.

- Prior control rather than action subsequent to merger.
- Predictability and transparency in the application of criteria for evaluating mergers.
- Control of all three types of merger – horizontal, vertical or conglomerate.

As to implementation procedures, OECD's report suggests:

- Mandatory prior notification of proposed mergers to ensure that those with a potentially substantial impact do not escape control and to obtain essential information on the merging firms.
- Deciding as quickly as possible whether or not the merger will be allowed. Because of the increasing number of *international* mergers, OECD's Committee on Competition Policy will focus on this aspect of mergers in its future work. Member governments can, it is suggested, avail themselves of a 1979 Council Recommendation which sets out procedures for cooperation in investigating mergers which involve foreign interests.

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1. Inter-country comparisons are made difficult by the varying coverage of merger data as well as the different periods for which data are available.

2. This index measures the market shares of the largest firms in the industry but also the level of concentration of the industry as a whole.

Property Taxes: A Reassessment

by Jeffrey P. Owens[1]

Taxes on immovable property are a major source of tax revenue for local government in most OECD countries (Table). A new OECD report contributes to the current debate concerning these taxes[2].

The primary role of the property tax is to provide revenue to finance local government services. Among the reasons why it may have been chosen for this role are:

- Property cannot leave a locality, which means that the tax cannot easily be evaded.
- The revenue yield is reasonably predictable.
- The rate of the tax can differ from one locality to another without a serious risk of encouraging migration of residents, labour or trade from high to low-tax areas.
- Perceptibility of the tax is high, and this may encourage local government accountability.

On the other hand, such taxes are frequently perceived as inequitable, and governments have, in practice, found difficulty in maintaining receipts from them in real terms.

The Main Policy Issues

The debate on the role of property taxes has tended to focus on four sets of issues:

Who pays the tax?

As in other areas of public finance, the question turns on tax incidence and not on who is legally responsible for the payment of the tax. The incidence of a property tax depends upon how the tax is shifted and requires identifying who is worse off as a result of the tax. If, for example, the occupier of a house pays the tax but is able to shift it back to the owner in the form of lower rent, the tax will fall on the owner. Although economists have been unable to find unambiguous results for the complicated process of tax shifting, it has been suggested that these taxes may not be as regressive as was once thought, and some commentators even regard them as progressive. Among the relevant factors in judging this question are how much rent control there is, how many householders own their own homes and the extent to which housing markets are controlled. Clearly, if this so-called "new" view of the property tax is accepted, one of the main arguments against it is refuted.

How fair are these taxes?

This question has been much debated, especially in countries like the United States and the United Kingdom where they are respectively the main and sole source of local government tax revenues. Because property taxes are generally based upon the value of the property and not upon the personal circumstances of the taxpayer, they are frequently criticised as being unfair in that taxpayers in similar personal circumstances may have very different tax bills. Countries have tried to deal with this in different ways. Some have introduced allowances related to personal circumstances and income; others have allowed tax to be deferred for a number of years (in the case of pensioners for example so that the estate pays the tax); still others have refunded the tax to those with low incomes. Yet claims of unfairness continue to be made, perhaps because taxpayers' perceptions of these taxes are different from those of economists or governments. The reasons for this discrepancy may be: infrequent and therefore large revaluations; tax payments which have to be made in one lump-sum amount; wide discrepancies between property-tax burdens in different parts of the country or even within a single area. A number of governments have tried to influence these perceptions by providing more information on the uses to which these tax revenues are put and by allowing payments in installments.

Do taxes on property distort urban development?

Although most governments see these taxes as a means of financing local government and not as an instrument to influence the pattern of urban development, they may nevertheless have unintended effects on location decisions. For example, differences in effective property-tax rates from area to area may influence firms in their decisions about where to locate their activities, at least insofar as they are not fully capitalised into property values. In practice, however, these effects seem to be less important than the impact of government controls on land use.

How easy are property taxes to administer?

Because property taxes are mainly local taxes, they have to be easy to administer. One advantage of property taxes over some other potential local tax sources (e.g. profits taxes) is the fact that the tax is levied on immovable property, and this facilitates assessment and collection. The information on the tax base is readily available to local authorities, and the property serves as security for the tax liability. The cost of administering property taxes depends upon how the tax is structured (the extent to which tax relief is available,

WHAT ARE PROPERTY TAXES?

They are compulsory taxes which relate specifically to the ownership, occupation or development of land and buildings. For the most part they are levied annually upon the capital value of a property or upon proxies for capital value such as the presumed or actual rent of the property. They are usually paid to local government.

1. *Fiscal Affairs Division of OECD's Directorate for Financial, Fiscal and Enterprise Affairs.*

2. Taxes on Immovable Property in OECD Member Countries, *OECD, Paris, 1983 (Joint report of the Committee on Fiscal Affairs and the Ad Hoc Group on Urban Problems). The report covers fourteen countries, all those with major property taxes except Canada.*

MAJOR RECURRENT TAXES ON IMMOVABLE PROPERTY

Country	*Tax*	*Basis of valuation*[1]	*Beneficiary Government*	*Yield as % of GDP*[2]	*Yield as % of Tax Revenue of the Relevant Level of Government*[2]
Australia[3]	Land Tax	Capital	State government	0.27	6.0
	Rates[4]	Capital	Local Authorities	1.19	97.0
Denmark	Land Tax	Capital	Municipalities and Counties	1.24	n.a.
	Service Tax	Capital	Municipalities and Counties	0.18	n.a.
France	Land and Buildings Tax	Annual	Municipalities	0.15	1.0
	Land Tax	Annual	Municipalities	0.39	0.1
	Professional Tax	Annual	Municipalities	0.60	1.5
Germany	Real Property Tax (Grundsteuer)	Capital	Municipalities	0.37	12.6
Ireland	Rates	Annual	Local Authorities	1.16	100.0
Japan	Fixed Assets Tax	Capital	Municipalities	1.15	33.9
	City Planning Tax	Capital	Municipalities	0.19	5.7
	Special Land-Holding Tax	Capital	Municipalities	0.03	0.9
Netherlands	Municipal Tax	Capital	Municipalities	0.61	92.0
	Contributions to Polder Boards	Surface and Annual	Polder Boards	0.13	43.0
New Zealand	Land Tax	Capital	Central Government	0.05	0.01
	Rates[4]	Capital or Annual	Local Authorities	2.22	92.7
Spain	Rural Land Tax	Annual	Local Authorities	0.02	1.5
	Urban Land Tax	Annual	Local Authorities	0.11	7.9
Sweden	Municipal Guarantee Tax	Capital	Municipalities	0.40	n.a.
Switzerland[5]	Recurrent Tax	Capital	Communes	0.18	0.7
Turkey	Immovable Property Tax	Capital	Central Government	0.25	n.a.
United Kingdom	Rates[4]	Annual	Local Authorities	3.30	100.0
United States[6]	Property Tax	Capital	State and Local Authorities	3.60	35.5

*1. **Capital** refers to the capital value of the immovable property, and **annual** to the yearly rental value, which may be gross rental income, net rental income or some adjusted figure.*
2. Refers to 1979.
3. State of New South Wales.
4. Rates is the Anglo-Saxon term for property tax.
5. Canton of Zurich.
6. State of Wisconsin.

for example), the number of taxpayers, the frequency of valuations, the extent to which the system is computerised, etc. Computerisation has undoubtedly lowered these costs, and many localities (e.g. Boston) are now able to update annually the property values on which the tax is based.

Local Government Accountability

Responsible local expenditure policies may be encouraged if increases in such expenditure are financed from local sources. Thus, it is usually argued that spending powers should be accompanied by the power to raise taxes and that as many local residents as possible should have to pay taxes so that they have an interest in local fiscal policy.

In most countries, however, national governments impose limitations on local governments' power to raise revenue from property taxes. Such restrictions may conflict with the desire to increase local accountability. Limits may apply to what type of taxes may be used by local government, the composition of the base, and/or minimum and maximum tax rates. National governments may feel the need for such limits so as to avoid any conflict with macroeconomic goals or to prevent increases in the published price indices (when property-tax changes are taken into account in the calculation of such indices) or because too much autonomy may encourage the creation of local tax havens.

In the United States, taxpayers themselves can impose limits on local governments' ability to raise revenues. The experience of California with Proposition 13 is an example. As the result of a 1978 referendum amending the California Constitution, which was supported by a substantial majority of the voters, a ceiling of one per cent was set on the local property tax, and assessed values were frozen at the 1975 level except for new construction and property changing hands thereafter.

Development in the Sahel: A Time for Action

While there has been encouraging progress in implementing the Club of Sahel's Development Plan for the period 1978-2000 – increases in development aid and a greater understanding of development constraints in the Sahel on the part of the international community – there has been no correction of the fundamental economic and ecological imbalances. Among the most disturbing trends:

- Population growth has outpaced modest improvements in food production, leaving the region farther away from the goal of food self-sufficiency, more vulnerable to natural disasters and more dependent on foreign aid.
- Desertification or land degradation continues to spread faster than progress made by forestry projects.
- Foreign indebtedness has reached critical levels in many Sahelian countries.

If the Sahel's primary goals of regional food self-sufficiency and ecological equilibrium are to be attained by the target year 2000, far-reaching improvements will have to be made in several areas:

Food. In the Sahel, food supply essentially means cereal crops, which account for approximately two thirds of all calories consumed. Cereal production has recovered somewhat since the early 1970s when drought reduced yields to an all-time low (Table 1), but long-term trends indicate a growth rate of only 1 per cent a year. Hence, cereal production is in a losing race with population growth which is a disturbing 2.7 per cent a year. Without improvement in production factors or fertility rates, as envisaged by the CILSS and Club du Sahel , by the year 2000 the Sahel would have to import well over 3 million tons of cereals per year to feed its 50 million inhabitants – of whom as many as 50 per cent will live in cities compared to 16 per cent now.

The outlook for other food sources – mainly livestock and fisheries – is not reassuring. Since the severe drought of 1968-1973, herds have been reconstituted to pre-drought levels but cannot expand further due to a lack of pastureland and water.

Reports submitted to a recent high-level Conference of the Club du Sahel[1] suggest that the region is at a turning point. Will the drought-prone Sahel move forward towards food self-sufficiency and ecological balance or will it remain in poverty and economic dependence?

Maritime and inland fisheries could contribute more to making up the Sahelian food shortfall (the former is estimated to have a supply potential of 2.7 million tons per year), but this source of food remains poorly exploited.

CLUB DU SAHEL

Founded in 1976 with the support of OECD Member states, the Club du Sahel is an association of eight West African countries (Cape Verde Islands, Chad, Gambia, Mali, Mauritania, Niger, Senegal, Upper Volta) and the numerous governments and international development agencies interested in the Sahel. In coordination with CILSS (Permanent Interstate Committee for Drought Control in the Sahel), the Club has established a framework within which donors and Sahel countries have established a partnership. The Club du Sahel has been active in promoting policy dialogue on a number of topics, including food production, recurrent costs and reforestation. The Club du Sahel Secretariat is located at OECD Headquarters in Paris.

1. CEREAL PRODUCTION AND IMPORTS, 1970-1981

in thousand tons

	Production[1]	*Imports*
1970	4,865	424
1971	4,214	496
1972	4,517	563
1973	3,502	859
1974	3,613	1,025
1975	4,857	548
1976	4,637	713
1977	5,184	786
1978	4,851	976
1979	5,889	751
1980	5,232	902
1981	5,601	825

1. Production is that of the previous year so that the table shows the availabilities of cereals in the year cited.
Source: *FAO.*

Water. As a Gambian delegate to the Club du Sahel conference remarked: "The problem of the Sahel can be boiled down to one word – drought."

Since 1978, approximately $111 million in official aid, representing 1.4 per cent of total official aid to the Sahel, has gone to the development of village hydraulic systems. While this official assistance (complemented by private aid of some $2 million per year) has helped considerably, water supply in the Sahel is still grossly inadequate. It is estimated that only 25 to 30 per cent of the rural population has sufficient access to water.

Untapped water supplies do exist in the Sahel, both underground and in the several major river systems of Gambia, Niger and Senegal. Known groundwater sources

1. The conference held in Brussels from October 26-28, at the invitation of the European Commission, brought together representatives from Sahelian member states, donor countries and international organisations. Previous high-level conferences were held in Dakar (1976), Ottawa (1977), Amsterdam (1978) and Kuwait (1980).

It is estimated that only 25 to 30 per cent of the rural population of the Sahel has sufficient access to water, but untapped resources exist. Above: a "water point" in Upper Volta.

could accommodate an additional 70,000 modern water points, and a network of dams is already beginning to exploit the Sahel's vast irrigable land potential estimated at 2.3 million hectares.

For the Sahel to take advantage of its available water sources, it must continue to benefit from foreign aid and implement a rational water-management policy. This means that government administrations will have to do more of what they do best – establish priority areas, determine specifications for facilities and equipment, ensure that completed projects are maintained – and less of what they are least equipped to do – construction and management of services.

Land Degradation. The Sahel's dominant environmental problem remains land degradation which, according to the United Nations Environment Programme, takes over potentially productive land at a rate of some 1.5 million hectares per year.

Efforts to control land degradation and establish a foundation for ecological balance have centred on forestry development. In recent years, much greater attention has been given to this historically neglected problem. Due in large part to the Club du Sahel, forestry projects have received twelve times more assistance on the average in the past three years than before the Club was founded in 1976. Nevertheless, outside financial support is still relatively limited, accounting for only $168.5 million or about 1.5 per cent of all official development assistance between 1975 and 1982.

The early results of forestation efforts have been mildly encouraging, but problems remain. Industrial plantations using exotic, fast-growing species have been costly and only slightly more productive than indigenous growth.

A human element has also presented itself as a key factor in preventing forestry development. Local populations have not been sufficiently involved in such projects, partly because they are too often designed and implemented from the top down, and partly because of traditional antagonisms between rural populations and Sahelian forest services. The latter have generally been viewed as a kind of rural police force rather than a force for development.

Forestation must therefore go beyond simply planting more trees. A better understanding of the economics and consumption patterns of fuelwood is vital since nearly 90 per cent of the estimated 18 million tons of wood consumed annually are used to meet energy needs. Efforts to reduce fuelwood consumption through the dissemination of improved cookstoves have not been universally successful; design flaws have resulted in stoves that are not as efficient as had been hoped, provoking resistance on the part of some consumers to using the new technology.

Despite the great demand for wood as an energy source, the Sahel is potentially self-sufficient. The results of a CILSS computer study indicate that a regional fuelwood surplus of over 4,630 metric tons could be attained by the year 2000 if consumption declined by 1 per cent a year, natural woodland yields were improved and new planting received increased government and local support. The alternative, if current trends remain unchanged, is a deficit of over 7,600 cubic meters by the end of the century and continued land degradation.

Recurrent Costs: Planning Now to Pay Later

Since 1978, the Club du Sahel and CILSS have been attacking the problem of recurrent costs[2] to ensure that completed projects receive sufficient financing for sustained operation and maintenance. The first major study on recurrent costs in development literature was published in 1980 under CILSS-Club du Sahel sponsorship and inspired a set of recommendations for Sahelian governments and donors:

- When drawing up national and programme project budgets, the implications of recurrent costs must be taken into account.
- Pilot experiments should be made before undertaking major projects.
- When preparing the technical aspect of a project, a study should be made of alternatives most suited to conditions in the Sahel.
- Make more use of decentralised taxation, user charges and public service tariffs to finance operating and maintenance costs.
- Review the role of costly public corporations and encourage private sector initiatives.

Development Aid

Although financial assistance and other forms of aid do not, by themselves, provide an answer to all problems in the Sahel, they will be necessary in sufficient and depend-

2. *An operational definition of recurrent costs has been proposed by a CILSS-Club Working Group: the set of annual flows of gross expenditure of the government and its agencies, in local currency or foreign exchange, undertaken in order to generate socio-economic benefits in connection with the operation and maintenance of a unit of installed capacity, regardless of the source of finance of the expenditure in question, domestic or foreign.*

Recurrent Costs of Development Programmes in the Countries of the Sahel: Analysis and Recommendations, *Clive Gray and Andre Martens, Rapporteurs; CILSS-Club du Sahel, August 1980.*

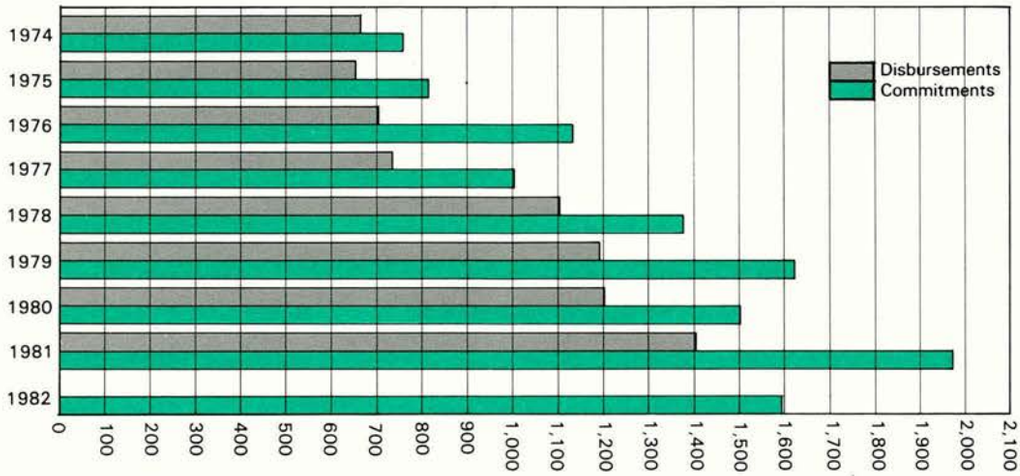
able quantity if the goals envisioned in the *Sahel Development Programme* are to be achieved. The Brussels Conference made clear that true regional development is possible only if a wide range of interdependent projects are carried out simultaneously.

The Sahel has benefitted from growing interest and support from the international community over the past eight years. As Chart A indicates, total official development aid has more than doubled since 1974. Since 1980, aid commitments have been 26 per cent higher than during the previous three-year period, and the Sahel now figures among the largest recipients of per capita assistance.

The opposite – and more disturbing – side of this coin is the large role that aid plays in Sahelian economies, representing 15 per cent of total Sahelian GNP, and over 20 per cent of GNP in half of the Sahelian countries (Table 2).

Although most of the aid is on concessional terms, a growing debt and debt-service burden is being carried by the region as a whole and several countries in particular. While the Sahel's foreign debt is modest in absolute terms compared to such countries as Brazil and Mexico, when debt and debt service are considered in terms of GNP, the Sahel ranks as one of the most seriously indebted areas of the world (Table 3).

AID FOR DEVELOPMENT IN THE SAHEL, 1974-1982
$ million (current prices)



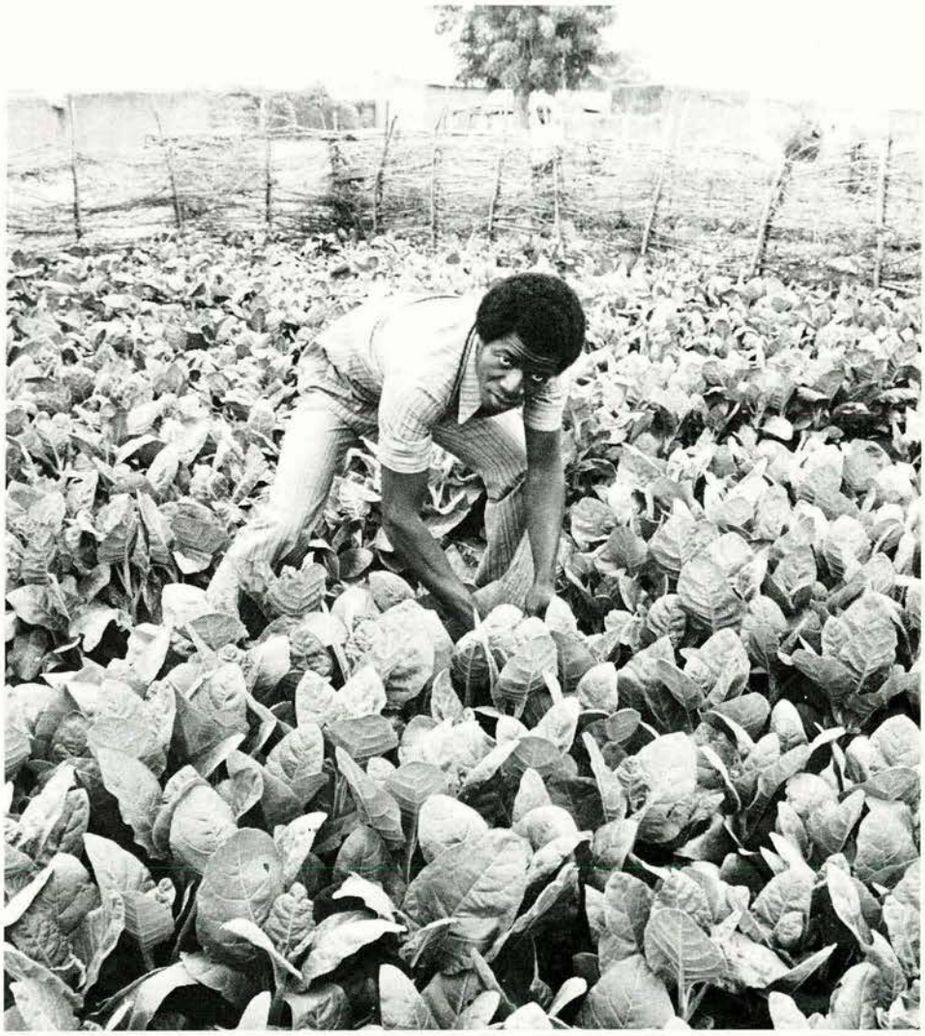
Towards the Future

With the completion of the first phase of the *Sahel Development Programme,* the moment is a propitious one for reassessment and action. There is enough experience to draw some important lessons from phase one and enough time to act upon those lessons. In the view of the Club du Sahel and the CILSS, Sahelian governments must:

- Encourage local populations to take the initiative in all aspects of project concep-

Every tree in the Sahel is important.

Small-scale irrigation can permit food security at the village level.



2. THE ROLE OF AID IN THE SAHEL ECONOMY

	GNP per capita in 1980 $	Aid per capita in 1980 $	Aid/GNP %
Cape Verde	200	161	80
Gambia	250	90	36
Mauritania	326	106	32
Upper Volta	160	35	21
Mali	201	36	18
Senegal	465	46	10
Niger	356	32	9
Chad	111	8	7
All SAHEL Countries	262	39	15

Sources: *1981 World Bank Atlas and OECD/DAC.*

3. FOREIGN DEBT AND DEBT SERVICE OF SAHEL COUNTRIES IN 1980

	GNP per capita $	Debt per capita $	Debt/GNP %	Yearly Debt Service per capita $	Debt Service/GNP %
Mauritania	440	487	110	25.0	5.7
Gambia	250	200	80	2.3	0.9
Mali	190	91	50	2.5	1.3
Niger	330	120	40	17.0	5.1
Senegal	450	168	40	31.0	6.9
Chad	120	36	30	2.7	2.2
Upper Volta	210	49	20	2.8	1.4
For reference:					
Mexico	*2 135*	*623*	*30*	*137.0*	*6.4*
Brazil	*2 050*	*480*	*20*	*116.0*	*5.6*

Source: OECD/DAC.

tion, implementation and maintenance

- Ensure that the pricing structure for agricultural products gives farmers an incentive to produce and that it reduces marketing disincentives
- Give more attention to planning projects and supporting them once completed
- Be willing to make greater investments in environmental projects that have limited short-term returns but are vital to the long-term ecological balance of the region.

Donor countries must maintain their procedures and devote the aid necessary to support host-country reforms leading to a sustainable cycle of development.

For their part, the Club du Sahel and the CILSS will act upon the mandate they were given at the Brussels Conference to assist national governments in organising progress-review meetings where donors and host countries can coordinate activities and discuss constraints.

For the Sahel, all options remain open. Vulnerability to the vagaries of weather and international economic conditions suggest that, if the Sahel does not move forward, it could face an intolerable future of economic stagnation punctuated by periodic crises. Yet with outside help and through a careful use of its own natural and human resources, progress can continue.

Women in Development - New DAC Guiding Principles

Although studies have shown that family health and nutrition improve as women's income increases, the role that women can play in development is not always taken into account by aid agencies. While some aid projects and programmes undoubtedly have helped the social and economic conditions of women, others have had a negative impact because of lack of attention to women's needs and opinions. To avoid such adverse effects and to encourage women's participation in the development process more generally, OECD's Development Assistance Committee, at a recent high-level meeting, approved a set of guiding principles for aid agencies, the main points of which are summarised below[1].

Women in the developing countries understand their own problems and can offer practical solutions if their views are sought and heeded. Care must be taken by donors, in consultation with beneficiary countries, to ensure that women are brought into the process of decision making in designing, developing and implementing all activities of aid agencies.

Policy directives on the role of women should be integrated into all aspects of development cooperation by each individual DAC Member country. Overall policy on the role of women must be supplemented with policies at sectoral and project level. At the same time, at least initially, it may be necessary to carry out projects – again in cooperation with recipient countries – explicitly designed for the benefit of women.

In applying these guiding principles, the choice of project must of course be governed by the priorities of individual recipient

1. *The complete text of the guiding principles can be obtained from the* OECD Observer.

countries, many of which have themselves accepted commitments to respect women's right to participate in the process of development - and to benefit from it. Whatever measures are taken should be firmly and explicitly based on specific mandates (legislation, ministerial directives etc.) in the donor countries.

Income Creation and Training

Women are more and more the breadwinners in developing countries, and their incomes, both formal and informal, contribute to the welfare not only of the family but of the nation as a whole. If women's needs for income and employment are to be taken into account, planning of projects must alleviate the constraints caused by demands on their time and energy for work in the home and in food production; at least any increase in their work load resulting from development projects must be avoided.

Ensuring that women have access to productive resources – which is a prerequisite for their participation in development – involves solving other problems: those concerning the right to own land and to obtain credit and banking facilities, for example. In projects not dealing directly with women, it is important to avoid any aggravation of these problems.

Access to productive resources cannot be achieved without increased efforts to make available to women more training and education, particularly in the fields of health, nutrition, hygiene, family planning, disease prevention and new technologies.

Appraisal, Monitoring and Evaluation

In framing procedures, DAC Members should take into account the effect of development projects on both men and women at all stages of the programming cycle. Virtually all projects – and their financial, economic, political and sociological implications – should be subject to such analysis.

In designing projects, analysis should be taken one step further than the household to reveal what happens within the family.

DAC Members should pursue their efforts to expand the *information base* on women in development and to improve data collection at the micro and macro levels as well as to include the results of research so as to shed light on the true economic contribution of women and also to direct action to priority areas.

Mechanisms to ensure women's participation need to be built into projects at local level during the *preparation, implementation and evaluation* stages. Changes made in a project during the implementation phase should also be responsive to the needs of women. The views of recipient governments, local administrative personnel and local women's groups must be sought out.

* * *

In pursuing activities aimed at enhancing women's role in the development process, DAC donors should as far as possible co-ordinate their own efforts, improve links with non-governmental organisations, strive to involve multilateral organisations in the importance of women's role and assist recipient governments in co-ordinating their own efforts.

To ensure that measures to facilitate the participation of women in development are applied, DAC Members undertake to review the application of the guiding principles by supplying information yearly to the DAC on action taken. They should also review the implementation of the guiding principles just before the United Nations Conference on Women in 1985, and regularly thereafter.

Strengthening the Recovery

Highlights from *OECD Economic Outlook*, December 1983

Recent Trends and Prospects

Activity is now increasing in nearly all OECD countries. Over the last twelve months, OECD growth appears to have been about 3½ per cent, nearly 1 per cent faster than had earlier seemed likely. Growth expected during 1984, and into 1985, is much the same as projected six months ago, so that unemployment in the OECD economy as a whole may stabilize around its present rate of 9 per cent of the labour force. Average inflation may remain below 6 per cent in 1984, a little lower than expected earlier.

Within the OECD economy there is however likely to be considerable diversity. Recovery is well under way in the United States, and Japan too is looking more buoyant. By mid-1985 real GNP in North America and Japan may be 7 to 9 per cent higher than two years earlier. Recovery in Europe seems likely to be more modest, however, and perhaps also more fragile. By mid-1985, activity there may be some 3 per cent higher than two years earlier. Reflecting these developments, unemployment in the United States seems likely to continue falling: from a peak rate of 10.3 per cent in the second half of 1982, it may be under 8 per cent by the end of 1984. In Japan, unemployment may show little change, but in Europe some further rise seems likely, to reach perhaps 12 per cent in the first half of 1985.

Preconditions for a Sustained Recovery

Establishing conditions favourable to renewed growth, and to sustaining it thereafter, has been the main thrust of policy in the majority of OECD countries over the last three or four years. As background to consideration of prospects and policies, a certain amount of retrospect is therefore useful.

Considerable progress has been achieved in establishing preconditions for sustained growth of output and employment:

- *Inflation* has come down sharp-

1. GROWTH OF REAL GDP/GNP IN THE OECD AREA[a]
Percentage changes from previous period, seasonally adjusted at annual rates

	1982 Share in total	Average 1971 to 1981	From previous year			From previous half-year				
						1983		1984		1985
			1982	1983	1984	I	II	I	II	I
United States	40.5	2.9	–1.9	3½	5	3.3	7½	4¼	3½	3
Japan	14.0	4.8	3.0	3	4	1.7	4¾	4	3	3
Germany	8.7	2.5	–1.1	1¼	2	2.2	2¼	2	2	2¼
France	7.1	3.1	1.9	½	0	1.2	–1	¼	¾	1½
United Kingdom	6.2	1.4	2.0	2½	2¼	3.1	1½	3	1½	2
Italy	4.6	3.0	–0.3	–1½	2	–1.1	2¾	2	1½	1¼
Canada	3.8	3.8	–4.4	3	5	4.9	6	5¼	3½	2½
Total of above countries	84.9	3.1	–0.5	2½	3¾	2.6	5	3½	2¾	2¾
Other OECD countries[b]	15.1	2.8	0.7	1	2	0.6	2¼	2	1¾	1½
Total OECD	100.0	3.1	–0.3	2¼	3½	2.3	4¾	3¼	2½	2½
Four Major European countries	26.6	2.5	0.5	1	1½	1.6	1¼	1¾	1½	1¾
Total OECD *less* the United States	59.5	3.1	0.8	1½	2½	1.5	2½	2½	2	2
Industrial production:										
Major seven countries	–	2.8	–5.0	3½	5¾	4.7	10¾	4½	3¾	3¾
Total OECD	–	2.8	–4.4	3¼	5½	4.1	9¾	4¼	3¾	3¾

Other OECD Countries

	1982 Share in total OECD	Average 1971-1981	From previous year		
			1982	1983	1984
Austria	0.9	3.1	1.1	1	1
Belgium	1.1	2.8	1.0	0	1
Denmark	0.7	2.1	3.6	1¾	¾
Finland	0.6	3.5	2.5	2¾	3¼
Greece	0.5	3.9	0	0	1¼
Iceland	0	4.1	–3.1	–5¾	–2¾
Ireland	0.2	4.1	1.2	½	1
Luxembourg	0	2.5	–1.7	–2½	–1
Netherlands	1.8	2.4	–1.6	1¼	1¼
Norway	0.7	4.3	–0.5	1½	–½
Portugal	0.3	4.2	3.5	¼	–2
Spain	2.4	3.3	1.4	2	2¼
Sweden	1.3	1.8	0.6	1¾	2½
Switzerland	1.3	1.0	–1.2	0	2¼
Turkey	0.7	5.2	4.6	3	3¼
Total smaller European countries	12.8	2.8	¾	1¼	1½
Australia	2.1	3.0	0	–1¼	5¼
New Zealand	0.3	1.9	0.5	–½	0
Total of above countries	15.1	2.8	0.7	1	2
OECD Europe	39.4	2.6	0.6	1	1½
EEC	31.1	2.5	0.5	1	1½

a) *Aggregates were computed on the basis of 1982 GNP/GDP values expressed in 1982 US dollars.*

b) *Half-yearly data must be interpreted with care since for eleven of these countries, amounting to over 50 per cent of the total GDP of the smaller countries, half-yearly growth rates were obtained by a purely mechanical interpolation.*

ly. From a year-on-year peak of 13.6 per cent in early 1980, the most recent OECD rate – over the year to October – was 5.2 per cent, a rate last seen in the early 1970s; in the three largest economies, the United States, Japan and Germany, inflation was down to 3 per cent or lower. However, with rates close to or above 10 per cent in a number of countries – including two major ones – inflation differentials among OECD countries remain wide.

• *Budget deficits.* Widespread control of public expenditures, and increases in taxation rates in a number of countries, have reduced budget deficits, at least on a cyclically-adjusted or structural basis (see inset). This reflects an intensive and sustained effort. But continued recession has depressed tax yields and increased payments to the unemployed. Together with the consequences of high interest rates for public debt service, this has meant variously a lesser reduction in actual deficits, or even increases. In many countries the stock of public debt has increased significantly in relation to GNP.

• *Profits and real wages.* Profit shares (defined as the share of gross operating surplus in GNP) have improved over the last year or so in many countries, although rates of return on capital, especially in relation to real bond yields, remain low in comparison with earlier periods. Equity values have, however, quite widely recovered. Important elements in profit restoration have been an unexpectedly strong productivity performance and greater preparedness of labour to accept less than full indexation of wages to prices.

• *Investment,* though having fallen in many countries, has generally held up well, in gross terms, compared with output. Rationalization – in response to changes in energy and labour costs – has presumably been important; there have, of course, also been dynamic prospects for sales in certain new-technology areas. Even so, buoyant investment of the sort needed to sustain recovery and support large scale job creation has not yet been seen.

Meanwhile, some features of recent developments have been less propitious for sustained recovery:

• *Interest rates,* though having receded from their peaks, remain high in both real and nominal terms, especially relative to rates of return on many real assets.

• *Exchange rates,* assessed on the basis of current account prospects, have seemed out of line, with the dollar high and the yen, in particular, low. Movement towards seemingly more sustainable rates in late 1982 and early 1983 was subsequently largely reversed.

• *Protectionism and subsidization* of industry, including activities which appear to have no comparative advantage, seem fairly generally on the increase.

• *Debt problems* in the developing countries, though less immediately preoccupying than they were a year ago, have not gone away.

The Nature of Recovery

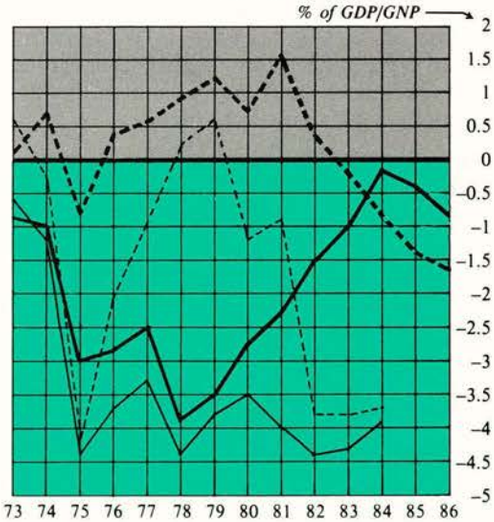
So far, recovery owes much to an increase in private consumption, arising from higher real incomes and also from a significant increase in the proportion of income that is spent. The increase in real household wealth that has accompanied the widespread decline in inflation would seem to be an important reason for this reduction in saving ratios.

Similarly, the increase in equity values may serve to sustain or increase spending by enterprises. It may enable firms to shift the balance of their financing towards equity and away from borrowing at still-high rates. There is some evidence that this is already occurring in the

HOW HIGH ARE STRUCTURAL BUDGET DEFICITS?

OECD's economists have attempted to estimate what the budget deficits of the major seven OECD countries would look like if the effects of recession were eliminated – that is they have tried to estimate the structural deficits (or high-employment deficits as they are also called) of these countries. Their findings are represented in the chart. Figures are shown up until 1986 based on the assumption that OECD economies will have reached their potential output by 1988.

GENERAL GOVERNMENT BUDGET BALANCES: ACTUAL AND STRUCTURAL, 1973-1986



USA: ----- *Actual budget balance*[1]
▪▪▪▪▪ *Structural budget balance*[2]
MAJOR SIX: ——— *Actual budget balance*[1]
▬▬▬ *Structural budget balance*[2]

Secretariat estimates and forecasts.

1. As per cent of actual GNP/GDP.
2. As per cent of potential or high employment GNP/GDP.

It can be seen that the emergence of a structural deficit in the United States is recent, the trend having begun in 1981. For 1983, the structural deficit in the federal budget is almost cancelled out by a surplus in the state and local sector; the overall government structural deficit is only about a quarter of 1 per cent of GDP. This compares with an actual deficit of 3.8 per cent.

For the United States there is an unambiguous trend towards structural budget deficit to 1988. According to the 1984 budget, economic recovery would, on current legislation, still leave a federal deficit of 3½ per cent of GNP in 1988 which, by definition, would be wholly structural. On the assumption that the state and local surplus remains at about 1½ per cent of GDP, this would translate into an increasing overall government structural budget deficit which could reach 1¾ per cent of GDP by 1986 and perhaps 2 per cent by 1988.

For the other six major economies, discretionary fiscal restraint has been pursued ever since the second oil shock (in contrast to the period following the first shock when deficits were deliberately increased). Hence structural deficits have been on the decline since 1979 and are now approaching balance. The actual budget deficit has been of the same order of magnitude as that of the United States, hovering around 4 per cent.

Future trends in structural budget deficits are difficult to evaluate for the major six. If recovery eases budget-deficit problems and advantage is taken of the scope for tax reduction, the trend towards structural budget surplus would be less strong than earlier.

2. PRIVATE CONSUMPTION DEFLATORS IN OECD AREA[a]

Percentage changes from previous period, seasonally adjusted at annual rates

	Average 1971 to 1981	From previous year			From previous half-year				
					1983		1984		1985
		1982	1983	1984	I	II	I	II	I
United States	7.4	5.8	4	5¼	3.2	4½	5½	5¾	5¾
Japan	8.4	2.9	1½	1½	1.2	1¼	1½	2	2¼
Germany	5.2	5.3	3	3¼	1.3	4	3	3	3½
France	10.1	10.8	9¼	7¼	10.0	9	7¼	6	6
United Kingdom	13.5	8.3	6	6	5.7	6	6	5½	5¼
Italy	16.0	16.7	14¾	12	15.5	12	12½	11	10
Canada	8.8	10.8	6	5	4.8	5¼	5	5	5¼
Total of above countries	8.2	6.6	4¾	5	4.2	4¾	5¼	5	5¼
Other OECD countries[b]	10.2	11.4	10	8¾	9.8	9	9	8¼	9
Total OECD	8.5	7.3	5½	5½	5.0	5½	5¾	5½	5¾
Four Major European countries	9.5	9.4	7½	6¾	7.2	7½	6¾	6	6
Total OECD *less* the United States	9.4	8.5	6½	6	6.3	6¼	6	5½	5¾

Other OECD Countries

	Average 1971 to 1981	1982	1983	1984
Austria	6.5	6.5	3¼	5
Belgium[c]	7.4	8.7	7¾	6½
Denmark	10.6	9.8	6¾	5¾
Finland[c]	11.8	9.2	8¾	8½
Greece	15.1	21.7	20½	18
Iceland[c]	38.4	54.0	83	26
Ireland	14.9	17.1	11	9
Luxembourg	7.0	9.5	9	8¼
Netherlands	7.6	5.7	2¾	3¼
Norway	8.9	11.9	8¼	6½
Portugal	18.5	22.5	24	23
Spain[c]	15.9	14.4	12	9½
Sweden	10.0	10.5	10½	5¾
Switzerland[c]	5.2	5.7	3¼	2½
Turkey	38.3	27.2	28	28
Total smaller European countries	10.1	11.4	10	9¼
Australia	10.9	10.5	10	7
New Zealand[c]	13.1	15.4	5	5¾
OECD Europe	9.9	10.1	8¼	7½
EEC	9.4	9.4	7½	6¾

a) *Aggregates were computed on the basis of 1982 values expressed in 1982 US dollars.*

b) *Half-yearly data must be interpreted with care since for eleven of these countries, amounting to over 50 per cent of the total GDP of the smaller countries, half-yearly growth rates were obtained by purely mechanical interpolations.*

c) *Consumer price index instead of national accounts implicit private consumption deflator.*

United States. Elsewhere, it is not clear how important a role such effects have played.

Confidence, an intangible but important element in the spending decisions of consumers and firms alike, also seems to have been improving, as measured by surveys, since about mid-1982 in the United States, and early 1983 in Europe and Japan. Resumed sales growth and expectations of lower inflation are probably at work, together with some restoration of gross profit shares. Improving confidence has probably put a floor under both consumption and investment.

Policy influences have also helped to lift OECD countries out of recession. This is clearest for monetary policy, where money growth, in the face of decelerating inflation, has provided scope for, and contributed to, an increase in real demand and output. Recently, money growth has been at or slightly above the top of target ranges in those countries which had placed particular emphasis on this approach to policy.

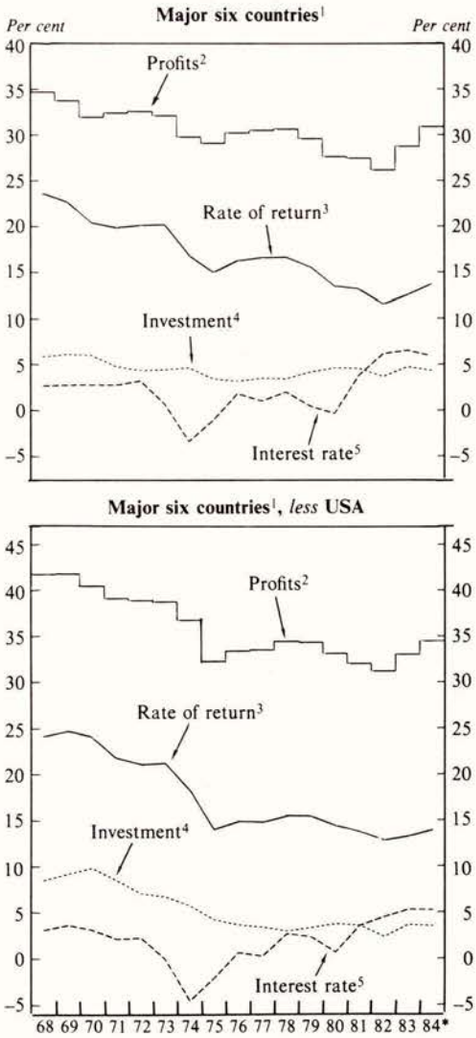
Declining inflation, by reducing the "inflation tax", has mitigated the restrictive impact of fiscal tightening. This is a wealth effect of the kind discussed above. Only in a small number of countries, however, including notably the United States, has discretionary fiscal policy had a demand-expanding stance.

Only in the United States is there so far clear evidence of a strong intention on the part of enterprises to increase real investment spending significantly. In Europe (and to some extent in Japan also), the investment outlook seems relatively modest, influenced by uncertain sales prospects, low capacity utilization and high real interest rates. This judgement could be wrong, and if so there would be important implications not only for the strength but also for the sustainability of the recovery. But until a strong pick-up in productive investment is clearly visible across all OECD economies, a major task will be to encourage this through appropriate policies.

Policies to Strengthen and Sustain Recovery

In *Europe,* many countries now set fiscal policy in a medium-term perspective, with the objectives of reducing deficits and containing public indebtedness; but there are significant differences in the pace of pursuit. Some place particular stress on the link between public sector deficits and interest rates, and hence the role that the reduction of public sector borrowing could play in recovery by permitting, encouraging or causing the "crowding in" of private sector investment. The effects on consumer and business confidence, and the responsiveness of the private sector, of government endeavours to reduce the size, or at least the rate of growth, of the public sector's involvement in the economy are also stressed. A complicating factor is that, given the strong mutual interdependence of the European economies, individual countries cannot look to export growth to spark off a pick-up in their domestic economies.

PROFITS, RATES OF RETURN AND INVESTMENT IN MANUFACTURING



1. United States, Japan, Germany, France, United Kingdom, Canada.

2. Gross operating surplus as a percentage of gross value added.

3. Gross operating surplus as a percentage of gross capital stock.

4. Growth of gross real investment.

5. Long-term government bond yeilds less the rise in consumer prices.

* *Forecast.*

3. UNEMPLOYMENT IN THE OECD AREA

National definitions

	1982	1983	1984	1982	1983		1984		1985
				II	I	II	I	II	I
Unemployment rates									
United States	9.7	9½	8	10.3	10.2	9	8¼	8	7¾
Japan	2.4	2¾	2¾	2.4	2.7	2¾	2¾	3	3
Germany	6.9	8½	9¼	7.4	8.2	8¾	9	9¼	9½
France	8.0	8¼	9¼	8.1	8.2	8½	9	9½	10
United Kingdom	11.0	11½	11½	11.4	11.7	11½	11½	11½	11½
Italy	9.1	10	10½	9.3	9.8	10	10½	10½	10¾
Canada	11.0	12	11	12.3	12.4	11½	11	11	10¾
Total of above countries	7.9	8¼	7¾	8.3	8.5	8	8	7¾	7¾
Other OECD countries	10.2	11¾	12¾	10.6	11.4	12	12½	13	13½
OECD Europe	9.5	10½	11¼	9.8	10.4	10¾	11¼	11½	12
Total OECD	8.4	9	9	8.8	9.1	9	9	9	9
Unemployment levels (millions)									
North America	12.0	12¼	10½	12.9	12.8	11½	10¾	10½	10¼
OECD Europe	16.0	18	19¼	16.6	17.5	18¼	19	19½	20¼
Total OECD	29.9	32½	32¼	31.5	32.7	32¼	32¼	32½	33

Other OECD Countries

	1982	1983	1984
Australia	7.1	10¼	10½
Austria	3.5	4¾	5½
Belgium	13.1	14¾	15
Denmark	9.9	10¾	11¼
Finland	5.9	6¼	5¾
Greece	5.8	6¾	8
Iceland	0.7	1	2
Ireland	10.7	14	16¼
Luxembourg	1.2	1½	1¾
Netherlands	10.0	13¾	16
New Zealand	5.3	6¾	8¼
Norway	2.5	3¾	3¾
Portugal	7.6	9	11¾
Spain	16.3	17½	18½
Sweden	3.1	3½	3¼
Switzerland	0.4	¾	½
Turkey	14.5	16	17
Total	10.2	11¾	12¾

In *Japan,* the structural rigidities which bedevil European economies have been largely absent. Macroeconomic policy has traditionally been pragmatic and flexible. For several years, however, the rapid build-up of public debt, the weakness of the yen relative to "fundamentals" and the sluggish trend of domestic demand have created problems for both fiscal and monetary policy. Nonetheless, the authorities recently announced measures aimed at achieving more balanced growth, a stronger exchange rate, and containment of the current surplus. For the medium term, however, important policy problems remain.

In the *United States,* there are important uncertainties about the way policy will affect economic performance, and hence setting policy calls for particularly careful judgement. The structural Federal budget deficit is likely, unless action is taken, to rise from its present figure of 2¾ per cent of GNP to much higher levels later in the decade. This prospective deficit may be an element in the present high levels of U.S. interest rates, which themselves affect not only the structure of demand but also the likely growth of the economy. Further, there is uncertainty about the causes of the present strength of the dollar, and hence about whether, or for how long, it will remain high. Possible policy changes apart, current account developments over the next two years, on the technical assumption of unchanged exchange rates, are dominated by the substantial widening of the United States deficit. It is against this general background that a change in the policy mix in the United States, through measures to reduce future budget deficits, is frequently advocated, both in the United States itself and elswhere.

A widespread view in the United States is that the strong dollar stems in part, though only in part, from high interest rates. Other countries are seen as benefiting importantly from the high dollar, and standing to benefit even more importantly in the future, with exports boosted as a result of strong competitiveness *vis-à-vis* the United States. On this view, other countries could have set their interest rates lower, with an attendant lower exchange rate, had they wished.

Meanwhile, a common European perception is that the inflation implications of any further depreciation of their currencies preclude an easing of monetary policy. The risk of further currency weakness – and its implications, in particular, for the climate of bilateral trade with the United States – has also been a consideration for Japan, though inflation has there been well under control.

Given their openness and continuing concern with inflation, most European countries have little alternative to having an objective for their exchange rate not too far in the background. But they should beware of the proposition that a reduction in U.S. interest rates, brought about by fiscal restriction, would by itself be sufficient to improve the prospects for Europe. The announcement of fiscal restraint in the so-called "out years" might, though this is not certain, lead current U.S. interest rates to fall, tending to stimulate and sustain activity in the United States – and throughout the world. But lower U.S. interest rates could also put the dollar under downward pressure. If the dollar were to depreciate, the United States would become more competitive and Europe less so: European export growth would tend to be weakened, both to the United States and in third markets, and U.S. export growth would strengthen. Dollar depreciation would push up inflation in the United States, tending to provide less room for real growth within given monetary targets.

Lower U.S. interest rates and a lower dollar would, however, have some positive effects on the world economy generally, which would in turn help European recovery. For example, the real burden of servicing dollar-denominated debt would be reduced, easing the financing constraint on developing countries' imports. And if the oil price proved to be sticky in dollar terms, it would tend to fall in terms of other currencies.

When ultimately the announced budget tightening took effect, the consequence would then be to lessen demand both in the United States and abroad. In a slightly longer perspective, however, it could be expected that the fiscal policy change would result in a more sustainable recovery.

Prospects for a decisive improvement in European performance would probably rest on the extent to which downward pressure on the dollar gave European countries the room to ease domestic monetary policy. Were lower interest rates to result, a remaining question would be the extent to which that might itself be sufficient to consolidate a European recovery.

Policies to Promote Stronger Medium-Term Growth

Achieving stronger growth is a matter of more than monetary and fiscal policy,

4. CURRENT BALANCES OF OECD COUNTRIES

$ billion; seasonally adjusted, at annual rates

	1981	1982	1983	1984	1982	1983		1984		1985
					II	I	II	I	II	I
United States	4.6	–11.2	–42½	–81¾	–26.4	–26.6	–58½	–72¾	–90¾	–99¼
Canada	–4.8	2.4	2½	1	3.5	2.7	2½	1¾	½	0
Japan	4.8	6.9	22½	31½	5.9	19.3	25¾	30	33	36
France	–4.7	–12.1	–5¼	1	–12.3	–9.8	–¾	–½	2½	4¼
Germany	–6.5	3.5	5¼	5½	5.2	5.3	5	5	5¾	7
Italy	–8.1	–5.5	1½	1	–4.6	1.8	1¼	1	1½	1½
United Kingdom	13.2	9.5	1½	2¾	12.5	1.4	1¾	2½	3	3¼
Total of above countries	–1.7	–6.4	–14½	–39	–16.2	–5.9	–23¼	–33	–44¾	–47¼
Other OECD countries	–26.4	–23.3	–9½	–3	–22.2	–9.8	–9½	–5¾	0	6½
Total OECD	–28.0	–29.8	–24¼	–41¾	–38.4	–15.7	–32½	–39	–44¾	–41
Memorandum item										
EEC	–13.6	–9.5	3	13¾	–4.3	0.5	5½	9½	18	24¾

Other OECD Countries

	1981	1982	1983	1984
Australia	–8.3	–8.4	–5	–3½
Austria	–1.4	0.5	½	1
Belgium–Luxembourg	–4.0	–2.7	–1	–¼
Denmark	–1.8	–2.3	–1	–½
Finland	–0.3	–1.0	–1	–1
Greece	–2.4	–1.9	–2	–2¼
Iceland	–0.1	–0.3	0	0
Ireland	–2.1	–1.3	–½	–¼
Netherlands	2.9	3.2	4½	6½
New Zealand	–1.2	–1.6	–¾	–¾
Norway	2.2	0.8	1¾	½
Portugal	–2.8	–3.1	–2¼	–1¾
Spain	–4.8	–4.2	–3½	–2¾
Sweden	–2.9	–3.5	–¾	–¼
Switzerland	2.8	3.6	3¼	3½
Turkey	–2.1	–1.2	–1½	–1½
Total	–26.4	–23.3	–9½	–3

important though these are. At the level of individual economies there is a need to consolidate and extend progress that has been made in establishing the preconditions for growth, and to halt and reverse the accretion of structural features that harm growth – that is, there is a need to strengthen supply forces. It is uncertain to what extent the marked difference between the strength of recovery in the United States and in Europe reflects conjunctural and policy-related developments, as distinct from more fundamental structural differences. But comparative employment performance over the past decade indicates the importance of the growing emphasis, in many European countries, on policies to increase flexibility and competition in labour and product markets as part of improved performance in the medium term.

As far as wages, prices and profits are concerned, the need remains to lower inflation in a number of countries and to contain it where it has already been brought down. Monetary policy will be important here. Building on the progress that has been made in weakening *de facto* or *de jure* links of wages to prices and on the climate of moderation which now tends to prevail, further wage restraint should be feasible, particularly with unemployment remaining high. On the other hand, the pick-up of non-oil commodity prices could be expected to gather momentum if a recovery of satisfactory strength developed. This is something that has to be accepted as part of the recovery process, because prices of many raw materials have been at levels inadequate to call forth investment in their production; and it would result in a needed improvement in the terms of trade of many less developed countries. It is important that cost increases from this source should feed through into final prices, but not into wages, thereby avoiding pressure on profits.

The preconditions for rising business investment may now be more satisfactory than for some time in a number of countries, and the prospect here may now turn crucially on a more certain growth of sales and higher rates of capacity utilization. Clearly a sustained fall in interest rates, and the improved climate that would flow from better structural policies and a reversal of protectionist trends, would be helpful.

As noted above, considerable progress has been made in reducing the structural – or non-cyclical – part of budget deficits in Japan and a number of European countries. But public indebtedness has risen sharply in relation to GNP, and is likely to remain high for some time. And in the United States at the Federal level, and in some other countries, there is a structural budget problem. Hence there is widespread concern to reduce budget deficits further, and general agreement that in the medium term this is necessary. Judgements differ with respect to the appropriate timing of action where the recovery is not yet clearly under way, and to the usefulness, or otherwise, of temporary support measures.

Supporting the recovery also requires appropriate policies at the international level. Recovery remains vulnerable to possible dislocation of normal trade and financial arrangements. An important area for action is the dismantlement of trade and market distorting measures built up over the last few years. It is generally accepted that where industrial, regional, trade or labour market policies serve to perpetuate inefficient economic structures, recovery potential is stunted. The challenge facing governments is to turn this into policy action: recovery will still leave hard-hit sectors in difficulty, and overall unemployment high, especially in the structurally weak economies. Pressures to sustain defensive measures will endure. Realistically, however, there is scope for making assistance more credibly contingent on restructuring, and for easing the employment consequences of a transition from protection and subsidization to less fettered markets. At their meeting in May, OECD Ministers "agreed that, within the framework of their overall economic co-operation, strengthening the open and multilateral trading system is essential to support the recovery and the transition to sustained growth. They therefore agreed that the economic recovery, as it proceeds, provides favourable conditions which Member countries should use, individually and collectively, to reverse protectionist trends and to relax and dismantle progressively trade restrictions and trade distorting domestic measures, particularly those introduced over the recent period of poor growth performance". Work to implement this agreement is under way in the Organisation.

Successful handling of international debt problems will also both facilitate, and be facilitated by, sustainable recovery in the OECD countries and resistance to autarkic tendencies. Countries must be able to export to service their debts, and to this end must have open access to growing markets. Some of the heavily indebted countries are only now adopting suitable adjustment programmes, but a number, including some of the biggest debtors, have made very considerable adjustment efforts. Here there will be a continuing need for finance until the recovery is substantially stronger, particularly if the indebted countries themselves are to keep their markets reasonably open.

8th December 1983.

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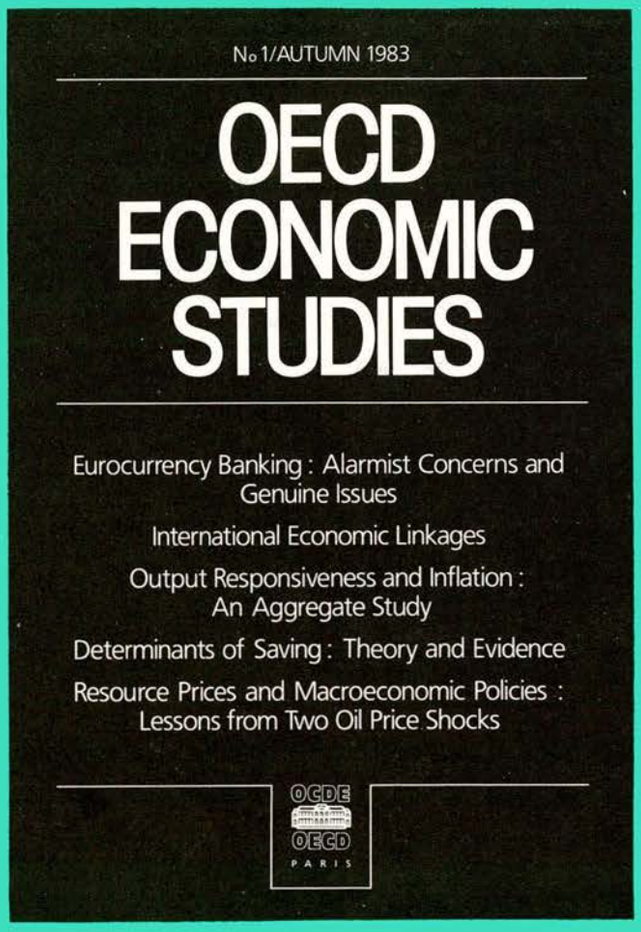

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