the OECD OBSERVER

Where are the Jobs Today?

Competition and Protectionism

Towards a New Consensus with LDCs

Oil Stocks to Counter Shortfalls

Economics and the Environment

No. 130 SEPTEMBER 1984

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the OECD OBSERVER

No. 130 September 1984

PUBLISHED bi-monthly in English and French by THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Annual Subscription Rates
Tel: (1) 524.81.66
£4.80 US11.00 F48.00
Single copies: £0.90 US2.00 F9.00

The OECD OBSERVER is produced in microform (microfilm and/or microfiche) by: (1) University Microfilms (Xerox), Ann Arbor, Michigan 48100, USA; (2) NCR Microcard Edition, Indian Head, Inc., 111 West 40th Street, New York, USA; (3) Bell and Howell Co., Old Mansfield Road, Wooster, Ohio 44691, USA.

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Fifteen Years of International Economic Co-operation

On 30th September, Emile van Lennep retires as Secretary-General of OECD after 15 years in which the nature of international economic problems and of international co-operation has changed perceptibly. The growing interlinkage of policy issues and of the Organisation's responses to them have characterised this period.

In the 1960s, the economic issues facing the international community were as prickly as they are today – but there were fewer of them. Economic co-operation between governments had been heavily concentrated on deploying to the best advantage the potential for economic growth that had been built up in the 1950s. A major preoccupation had been to keep competitive positions and relative demand pressures roughly in line as between countries, so that in an era when international capital flows were just beginning to develop, the Bretton Woods system of fixed but adjustable exchange rates could continue to function smoothly. The protracted sterling crisis, and the growing shadow over the dollar, had made this task increasingly difficult.

By the time Emile van Lennep's tenure began in October 1969, it was clear that the world was facing some very large – and often very new – challenges:

- Inflation had accelerated and become far more generalised. As early as 1970 OECD found it necessary to publish a report warning that economic growth would not endure unless this tendency were reversed by, among other things, allowing market forces greater play.
- The weakness of the dollar had recognisably become a case of fundamental disequilibrium.
- The possibilities began to surface of a severe energy supply problem at some time in the decade, if steps were not taken to avert it.
- The citizens of the OECD area were increasingly demanding that the economic process should provide satisfactory results not only in terms of quantity but also of quality – especially regarding the environment, education and social conditions.
- The problems of the Third World were calling for a joint effort by OECD and developing countries which went beyond traditional aid and technical assistance to involve new efforts in the fields of trade, investment, science and technology, agriculture and industry.

From the outset, the new Secretary-General, having spent many years as Treasurer-General of the Netherlands and as chairman of key international monetary committees, recognised that these challenges could not be met by a traditional sector-by-sector approach. Reflecting his views and experience, OECD's multi-disciplinary approach, from the early 1970s, was designed to ensure that the different aspects of policy-making were mutually supportive, and that action in pursuit of one goal did not pre-empt action towards others. At the international level, one result was to persuade different ministries to work together on a single policy and, at the national level, to encourage similar efforts.

The new challenges very quickly crystallised into a series of fast moving events to which the Organisation and Member governments, collectively and individually, had to respond throughout the 1970s and into the 1980s.

First, and particularly important, came the breakdown of the dollar-gold standard in August 1971 and the attempt to rebuild it, on the basis of a new pattern of exchange rates, at the end of that year. The discussions in OECD, on the basis of Secretariat work as to the size of balance of payments adjustments required if the dollar were to be restored as a firm anchor for the international monetary system, provided a major material input

The joint policy responses by OECD governments during these fifteen years grew from analytical work by the Secretariat, outside consultants, and Committees. Among the major studies, "Inflation: The Present Problem", (1970), went beyond demand management into a range of recommendations on the supply-side of economies. The Report of the High-Level Group on Trade and Related Problems, (1972), led by Jean Rey, former President of the EEC Commission, illuminated the growing inter-relationships between trade and monetary issues and laid the basis for the Tokyo Round of GATT negotiations. A study of long-term energy trends was launched in early 1972, basically to question the assumption that energy supplies would remain relatively cheap and abundant. Its time-frame was abruptly shortened by the oil crisis of late 1973, but the work under way was a valuable input to government responses from 1974 onwards. In 1976-77, the McCracken Group contributed significantly to Member governments' adoption of medium-term policies ("Towards Full Employment and Price Stability" [1977]). Two projects in the late 1970s influenced thinking on the future of North-South relations: "The Impact of the Newly Industrialising Countries", (1979), pointed to the emergence of the "NICs" in the developing world, while "Facing the Future", (1979), the report of the Interfutures Group, analysed the structure of the world economy out to the turn of the century.

A project on Social Policies in the 1980s brought social and economic policies together for the first time, leading to further related work on rigidities in the labour markets. Work on Trade in the 1980s, which showed the inter-relationships between trade policies, domestic economic policies and investment flows, provided the conceptual framework, inter alia, *for the current drive for dismantlement of trade barriers among OECD members, and between them and the rest of the world.*

into the eventual Smithsonian realignment. But, in an inflationary climate, the results achieved proved insufficient to restore confidence to the market; by early 1973 the world moved to a system of managed floating. Though there was little choice in the matter, some governments hoped to gain more freedom from international constraints; yet, if anything, floating intensified the need for the international dimension to be borne in mind in the design of national economic policies.

Into this new world of international monetary uncertainty, of excessive demand pressures, of accelerating inflation and a general commodity price boom, was injected the first oil crisis of 1973, which culminated in a quadrupling of the price of crude. While it was predictable that this was going to affect drastically the price levels and current accounts of Member countries, governments attached varying importance to the potential deflationary or inflationary dangers. If macro-economic co-ordination was less than satisfactory, in other respects international co-operation in the crisis was prompt and effective. Early in 1974 OECD countries agreed that for the industrialised world as a whole the adverse effects of OPEC I could only be reversed progressively by building up exports to the oil producers and by strong action to economise on energy use and develop alternative supplies. For this latter purpose, Member countries speedily set up the International Energy Agency. In the meantime, countries agreed, in part through the Trade Pledge, to avoid self-defeating efforts to offset their individual balance of payments deficits at each others' cost.

The oil price increases struck hardest at the economies of the non oil-producing developing countries, virtually offsetting the volume of aid funds that had been flowing to them. As an initial response, OECD Ministers in 1975 agreed that the Organisation should step up efforts to seek policies that would help strengthen the position of developing countries in the world economy.

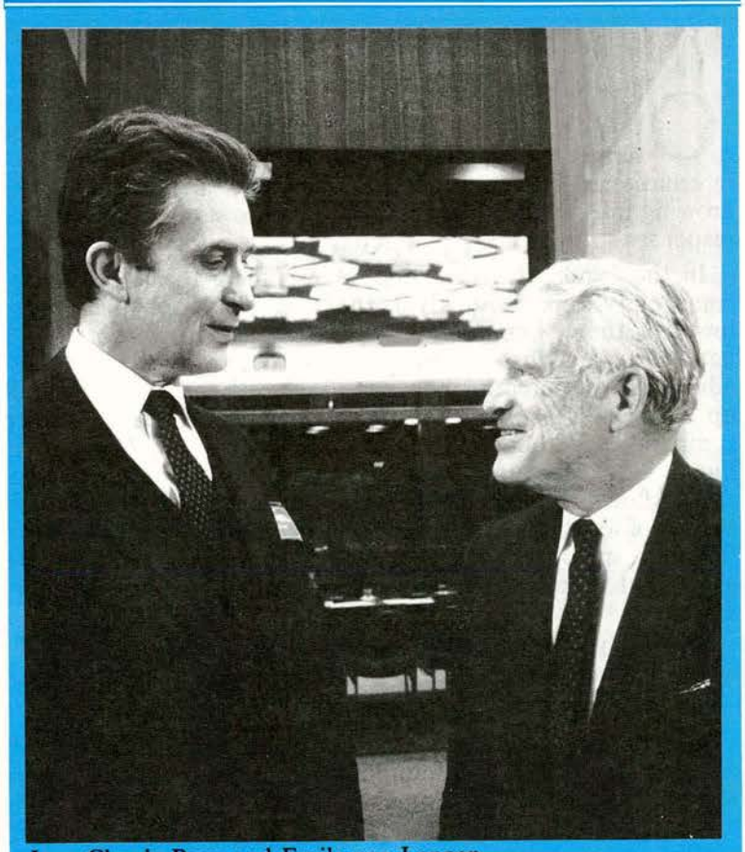
By 1975, a year of deep recession, yet of still-rampant inflation, OECD governments recognised that there was no quick way to return to the high employment that had followed previous post-war recessions. As a result, in 1976 OECD Ministers adopted a medium-term strategy for recovery, accepting the unpalatable fact that unemployment could only be brought down gradually, as the rigidities on the supply-side of economies would not permit rapid recovery. The move toward a longer-term framework of steady policies was strengthened during 1976 and 1977 by inputs from a group of outside economists led by Professor Paul McCracken of the United States. But the divergencies stemming from 1974, when OECD countries had failed to reach a common response to OPEC I, remained large. To correct this, Ministers reinforced the medium-term strategy in 1978 by the Concerted Action Programme, in which a few countries agreed to expand, others agreed to put higher priority on reducing inflation, and others renewed efforts to conserve energy. The concomitant Ministerial agreement to pursue "Positive Adjustment Policies" was the foundation on which OECD's subsequent work on structural adaptation had been based and marked the growing emphasis on the supply-side in economic management.

The 1978 agreement, demonstrating that varying kinds of action could be backed by certain common approaches, laid the basis for a new common response when, starting in 1979, the second oil crisis produced a fresh, serious challenge to OECD governments.

Their response to OPEC II proved considerably more homogenous and effective than the immediate response to OPEC I. There was overwhelming agreement among Member countries that priority had to be accorded to reducing the effects of the new inflationary forces unleashed by the second major oil price-rise: otherwise there could be no hope that the recovery process, halted by OPEC II, could be renewed. The success of this painful but essential OECD-wide effort has been reflected in the continuous decline of inflation from its 1980 peak and the first signs of reviving confidence throughout the area.

If responses to these trying problems have gradually allowed OECD governments to gain a firmer footing upon which to build, they still face the unfinished business of the 1980s: seemingly intractable unemployment in many Member countries, untenably high public sector deficits in others, and an international debt problem that could jeopardize world recovery.

But the experience with longer-term efforts since 1976 led governments by 1984 to focus more on policies designed to improve the underlying strength of their economies and of the world economy, with renewed emphasis on the interrelationships between economic efficiency, trade flows in an open market system, and the flow of domestic and international investment.



Jean-Claude Paye and Emile van Lennep.

The new Secretary-General of OECD, Jean-Claude Paye, has experienced these changes in the international economic scene from key posts in the French government, in the Commission of the European Communities and in close contact with OECD.

From 1967 to 1973 he was Head of the Private Office of Raymond Barre who was then Vice-President of the Commission with responsibility for economic and financial affairs. This was followed by a period in the Ministry of Foreign Affairs. When Mr. Barre became Prime Minister, Mr. Paye served as his Counsellor for international questions from 1976 to 1979. During part of this time he was Secretary-General of the French government's Interministerial Committee for European Economic Co-operation questions.

Since 1979 Mr. Paye has been Director for Economic and Financial Affairs at the Ministry of External Relations. In this post he also served, starting in 1980, as Chairman of OECD's Executive Committee in Special Session, the group that brings together OECD work in such fields as economic and monetary policy, trade, development, and investment flows. ECSS was established in 1972 as the centrepiece of OECD's multi-disciplinary approach to policy problems.

The Employment Outlook: Where are the Jobs in Today's Labour Market?

Although it has brought many people back to work in the United States, the present economic recovery is doing little to brighten the prospects of the unemployed in Europe. The fact that both the American and Japanese economies have created millions of extra jobs over the past decade while there has been a net loss of jobs in Europe raises fundamental questions about the job-creating capability of different economies within the OECD. As well as encouraging activity in the services sector, where the bulk of new jobs arises, governments need to consider measures to promote greater flexibility in the labour market. Meanwhile, they have to accept the responsibility of alleviating the distress and hardship of the present continuing high levels of unemployment, especially among the long-term unemployed[1].

The magnitude of the unemployment problem facing OECD countries was highlighted last year in the first issue of OECD's *Employment Outlook* which pointed out that almost 20,000 net jobs had to be created every day over the five-year period from 1984 to 1989 if OECD unemployment was to be cut back to its 1979 level of 19 million. North America and Europe would need to generate a little over 40 per cent of these new jobs each, and Japan about 10 per cent. On that basis, North America created more than the required number of new jobs last year, Japan came close to this target, but Europe suffered a substantial further increase in unemployment.

The contrast between the three main OECD regions in terms of job creation is stark and predates the recent recession. In the 10 years to 1983, almost 18 million additional jobs were created in North America and some five million in Japan, but in Europe there was a net loss of 1 ½ million jobs. Future prospects look much the same. Only in the United States is the economic recovery now underway expected to bring a strong growth in employment and a further decline in unemployment; in Japan, unemployment is likely to remain stable, while in Europe, the number of unemployed is forecast to rise from 18 million now to nearly 20 million by the end of 1985 – a record rate of 11.5 per cent of the total European labour force.

In the OECD area as a whole, there were almost 33 million people unemployed last year, a rate of 8.7 per cent. In 1979, the rate was 5.1 per cent, when 19 million people were seeking jobs. Only in Europe is the situation continuing to deteriorate. Unemployment in the United States has fallen to 7.4 per cent in May 1984, from a peak of 10.6 per cent in December 1982. Japan's rate peaked in August 1983 at no more than 2.8 per cent, and has declined slightly since then.

These diverging employment trends will combine to keep the overall OECD unemployment level at more than 31 million people. While there may be a small decrease in 1984, the rate is likely to drift upward again in 1985. Unemployment still bears particularly heavily on the young, but there are signs that this problem may be easing a little. In the 12 main OECD countries, the under-25s accounted for 40.8 per cent of total unemployment in 1983, compared to 44.6 per cent in 1979. This improvement is more a product of demographic trends than of labour market factors or government policies, though.

The other main consequence of a prolonged period of high unemployment is the growing number of long-term unemployed, defined as those who have been out of work for a year or more. The proportion of long-term unemployed has risen in all categories, but it is highest among the adult unemployed, especially those aged over 50. While the numbers of long-term unemployed will fall when unemployment falls, there is a lag; moreover, since unemployment overall is expected to remain at its present level in the OECD area over the next eighteen months, the short-term outlook for the long-term unemployed is not particularly hopeful. In Europe, for instance, the proportion of long-term jobless could reach 45 per cent in France, over 40 per cent in the United Kingdom and 30 per cent in Germany by the end of 1985.

While sustained and substantial economic recovery is a minimum condition for employment growth in the medium term, the process of structural change will also be a major determinant of the level of employment. Although structural change poses difficult adjustment problems for displaced workers and their communites, it indeed offers great opportunities for job creation and for improvements in living standards overall. A major challenge for governments in a period of high unemployment and uncertainty about future job prospects is to counter the understandable fear of, and resistance to, structural change. If change is to be viewed as an opportunity rather than a threat, economies need to operate with greater flexibility at all levels. In order to achieve higher rates of employment growth, therefore, the markets for goods and capital, as well as for labour, must function more efficiently.

In the labour market in particular, however, efficiency is not the only consideration and so governments intervene along with both sides of industry through the collective bargaining process to try to ensure that equity and human considera-

1. *The Employment Outlook,* OECD Paris, September 1984.

1. NUMBERS OF UNEMPLOYED PERSONS IN THE OECD AREA

Thousands

	1970	*1975*	*1980*	*1982*	*1983*
Australia	91	302	402	486	693
Austria	42	53	58	115	135
Belgium	69	168	311	465	514[a]
Canada	476	690	867	1,314	1,448
Denmark	17	121	164	290	312[a]
Finland	41	51	114	149	156
France	510	902	1,452	1,863	1,864
Germany	149	1,074	889	1,833	2,258
Greece	138	99	132	215	290[a]
Iceland	1	0	0	1	1
Ireland	65	73	76	137	180
Italy	1,111	1,230	1,698	2,068	2,278
Japan	590	1,000	1,140	1,360	1,560
Luxembourg	0	0	1	2	2
Netherlands[b]	45	260	326	655	801[a]
New Zealand	1	3	29	52	76[a]
Norway	12	40	33	52	67
Portugal	. .	222	330	316	388[a]
Spain	329	581	1,638	2,260	2,461
Sweden	59	67	86	137	151
Switzerland	0	10	6	13	26
Turkey[c]	1,792	2,120	2,651	3,279	3,634[a]
United Kingdom	555	838	1,513	2,770	2,984
United States	4,093	7,929	7,637	10,678	10,717
North America	4,569	8,619	8,502	11,992	12,165
OECD Europe	4,931	7,910	11,478	16,620[a]	18,502[a]
Total OECD	**10,186**	**17,834**	**21,553**	**30,510[a]**	**32,996[a]**

a. Secretariat estimates.
b. Data from 1975 onwards are not consistent with those of earlier years.
c. Including estimates for unemployment in agriculture.

Sources : OECD, *Labour Force Statistics; Quarterly Labour Force Statistics.*

tions are also satisfied. Such choices are particularly prominent when it comes to managing structural change. While assistance is afforded to those displaced by change, governments must frame polices so that the positive employment effects are encouraged.

Where the Jobs Are

New job opportunities are offered to some extent by the fast-growing high technology sectors of manufacturing industry but, above all, by the proliferation of financial, business, social and public services. The service sector as a whole has accounted for almost all net job creation in many OECD countries since 1975, but in most cases it has failed to generate enough jobs to offset both the growth of the labour force and the displacement of workers from agriculture and the traditional "smokestack" industries.

Almost six employed persons out of 10 in the OECD area now work in service activities, compared to 50 per cent in 1971 and 42 per cent in 1961. Industry as a whole now accounts for 32 per cent of employment, as against 36 per cent in 1961. The "degree of tertiarisation" has gone furthest in North America, where 69 per cent of the workforce is employed in services; elsewhere, the proportion varies from 50 to 65 per cent. Over the past 20 years, 72 million service jobs have been created in the OECD area, while total employment has increased by 60 million. Since 1975, the service sector has generated 23.5 million new jobs, while total employment has risen by 21.7 million.

In 1982, 44 per cent of those employed in services were in social and personal services, while about 30 per cent were in distribution, 12 per cent in financial or business services and 10 per cent in transport and communications. Between 1975 and 1982, most new jobs were created in social services, although the growth rate of employment was highest in financial and business services.

Service activities can be divided into two groups: those for *intermediate consumption by producers* and those for *direct consumption by households.*

Business and financial services are becoming closely integrated with industrial activities, especially in highly capital-intensive manufacturing industries. *Business services* include a wide variety of activities, ranging from project design and assistance to market research, marketing and advertising, security services, catering, cleaning and the provision of temporary staff. To some extent, the growth of these services represents a transfer of activities from industry to specialist service providers. These are generally small firms with a high

2. LONG-TERM UNEMPLOYMENT IN SELECTED OECD COUNTRIES

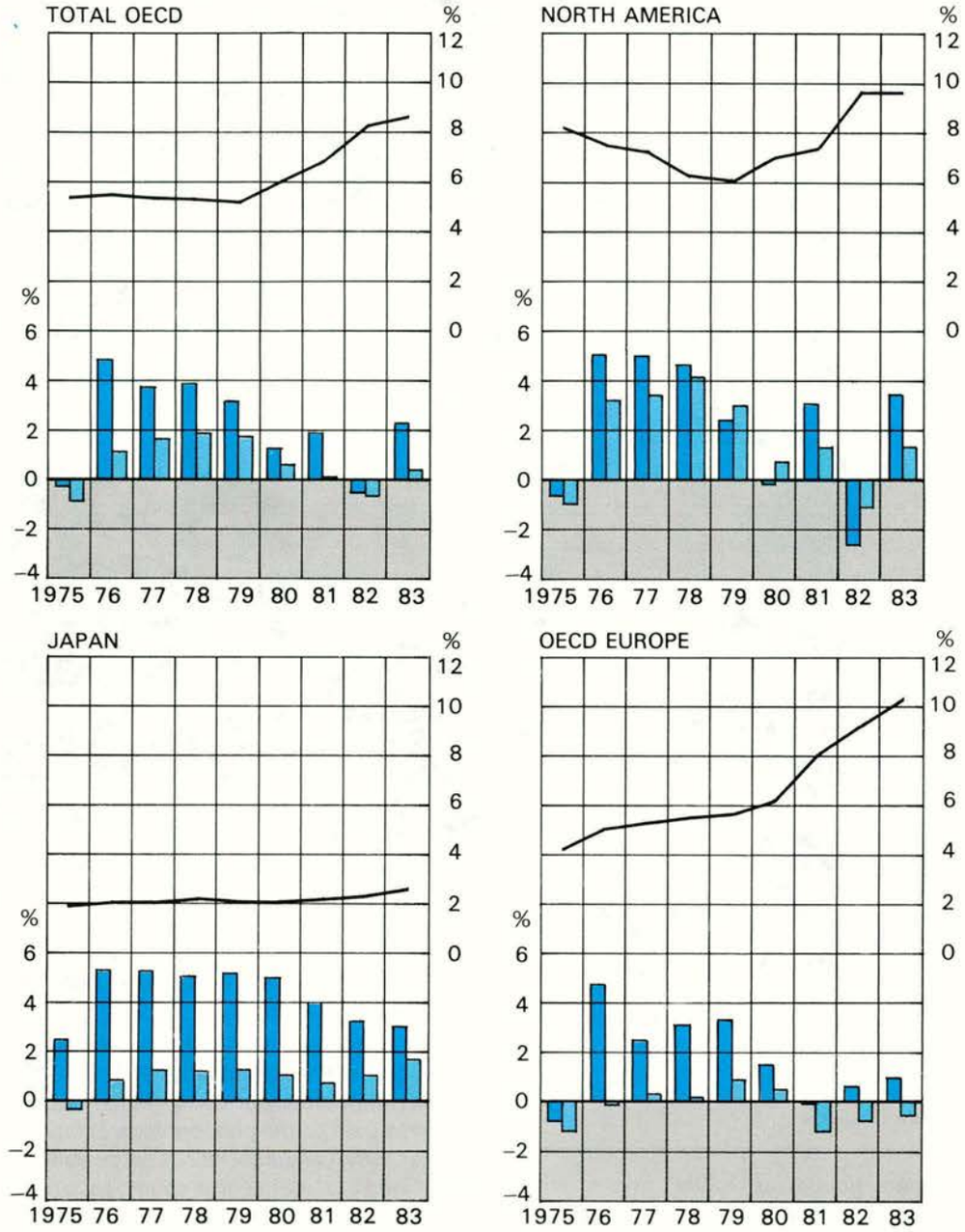
as percentage of total unemployment

	1979		*1981*		*1983*	
	6 months and over	*12 months and over*	*6 months and over*	*12 months and over*	*6 months and over*	*12 months and over*
Australia	38.0	18.1	39.0	21.1	52.8	27.6
Austria	19.4	8.6	16.1	6.5	25.8	9.0
Belgium	74.9	58.0	72.5	52.4	77.9	62.8
Canada	15.6	3.5	16.1	4.2	28.0	9.5
Finland	41.5	19.3	34.8	12.5	38.3	14.6
France	55.1	30.3	55.8	32.5	67.3	42.6
Germany	39.9	19.9	38.1	16.2	54.1	28.5
Ireland	47.9	31.8	48.9	30.5	50.9	31.0
Japan	38.1	17.2	30.3	13.4	n.a.	n.a.
Netherlands	49.3	27.1	48.7	22.0	69.6	43.7
Norway	7.9	3.0	15.0	3.0	17.9	7.0
Spain	51.6	27.5	66.8	43.6	71.3	53.8
Sweden	19.6	6.8	18.0	6.0	24.9	10.1
United Kingdom	39.7	24.5	45.7	21.6	57.8	36.2
United States	8.8	4.2	14.0	6.6	23.9	13.3

n.a. = not available.

Source: Measures of long-term unemployment are particularly uncertain, and international comparisons are difficult since the type of sources used varies from country to country. Data for Australia, Canada, France, Japan, Norway, Spain, Sweden and the United States are from household surveys while data for the remaining countries are based on registration records maintained by employment offices. In the case of France, Norway and Spain, persons for whom no duration of unemployment was specified are excluded from total unemployment. Measurement is at different times of year in different countries.

A. EMPLOYMENT, UNEMPLOYMENT AND OUTPUT



Sources:
OECD, *National Accounts,*
Labour Force Statistics,
Quarterly Labour Force Statistics.

Left hand scale:
Rate of growth of: (changes from previous year)
GDP
Total employment
Right hand scale:
Unemployment rate (a) average for year

(a) Standardized unemployment rate

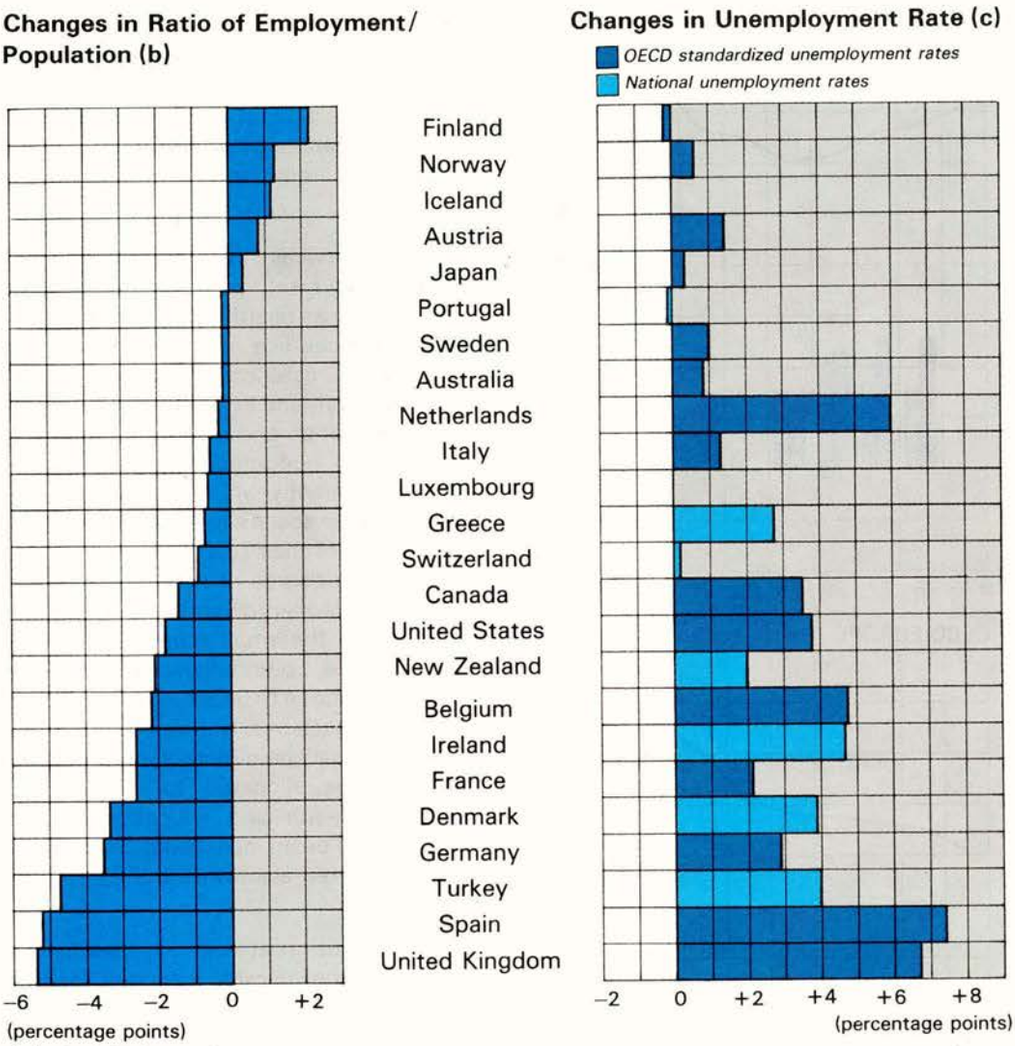
capacity for job creation. Skill levels vary greatly, with research, project engineering and consultancy firms employing highly qualified staff while those in security, cleaning and catering services employ a high proportion of unskilled labour, often with a majority of women or immigrant workers working part-time for low wages.

Employment in *financial services* – essentially banking and insurance – grew very rapidly in the 1960s, but started to slow down from 1976 onwards (although it has continued to increase substantially in the United States). Employment growth has been curtailed by the introduction of computerisation and other forms of automation, which have considerably raised productivity. Financial services are mainly concentrated in large enterprises and institutions, and most of the staff (60 to 80 per cent) are employed in non-supervisory jobs. They are usually occupied by women doing routine office work, very often employed part-time. The remaining supervisory posts are highly skilled and generally occupied by men. It is these jobs which are growing more rapidly, since increased automation has reduced the demand for labour to perform routine functions. Future employment in banking will similarly depend on the continued introduction of new technologies. The widely-predicted redundancies of unskilled labour have not yet taken place, and the banking industry talks in terms of stable employment in future, with labour being transferred within the business, from one form of routine work to another.

Direct services to households are extremely diverse, including non-market services such as health and education, and market services like retailing, repairs and maintenance, catering and personal services. Employment in public services like health, education and welfare depends on governments' budgetary choices and constraints. In recent years, the growth rate of employment in social services has declined, but because of their relative size, they are still the main source of service sector job creation. Moreover, given their low capital intensity and the small scope for technological change, community and social services will continue to be provided by people rather than machines. Hence, social service employment will be directly determined by the resources allocated to them, even though in health and education human resources are being increasingly backed up by sophisticated electronic and computerised aids.

Employment patterns in *distribution* have varied considerably from one country to another in recent years. Since 1975, for instance, employment growth has been vigorous in some countries (Australia, Austria, Canada, Greece, Japan, Norway, Portugal and the United States), but nil or negative in others (Belgium, Finland and Sweden). These differences are mainly due to divergent trends in the *retail trade;* the rapid concentration of the industry in the countries of Northern Europe and Spain has led to a fall in retail employment, as productivity has soared and many small establishments have disappeared. In *hotels, restaurants and cafés,* there has been a more uniform trend, with substantial employment growth occurring in many countries as a result of the burgeoning development of fast-food restaurants and the emergence of large hotel chains. The distribution sector has the second highest proportion of female employees after social services and the largest proportion of part-timers. It is also characterised by poor working conditions and longer-than-average working hours. All in all, a high proportion of the jobs in distribution are unskilled and poorly paid, and job security is relatively low. Future employment growth is expected to be limited, with the introduction of new technologies resulting in substantial productivity increases. →

B. CHANGES IN EMPLOYMENT AND UNEMPLOYMENT 1979-1982 (a)



(a) Period of recession
(b) Ratio of numbers in total employment to numbers in population aged 15-64
(c) Ratio of numbers unemployed to numbers in total labour force
Sources: OECD, Labour Force Statistics, Quarterly Labour Force Statistics

The service sector provides the majority of new job

Employment in other services has begun to stabilise, if not decline. In *transport and communications,* for instance, annual employment growth has fallen to under one per cent and is negative in some countries. Employment growth remains quite buoyant in telecommunications, though slower than a few years ago. On the other hand, employment has fallen sharply in some transport services, such as national railway systems.

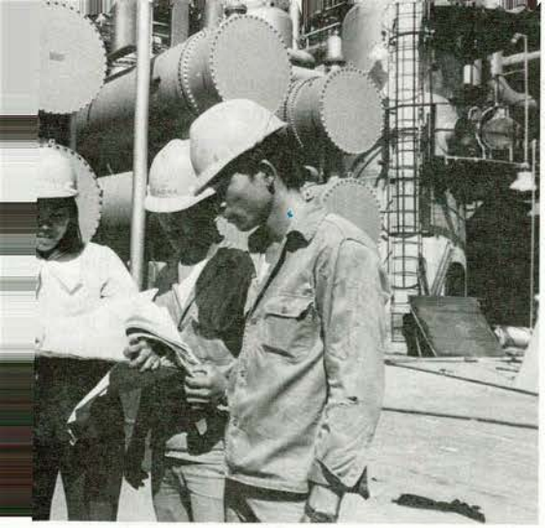
When it comes to *personal services* like recreational and cultural activities, cleaning, laundries and domestic services, employment has stabilised or fallen for two main reasons; firstly, the growth of the so-called "self-service economy" means that households have now acquired the consumer durables necessary to provide these services directly at lower cost (affecting laundry and entertainment services in particular); secondly, the rising cost of labour in these services has substantially reduced demand or shifted it to mass-produced goods at lower prices with increasingly short lifetimes. All told, the outlook for personal services, as for transport and communications, is for employment to continue to mark time, if not decline.

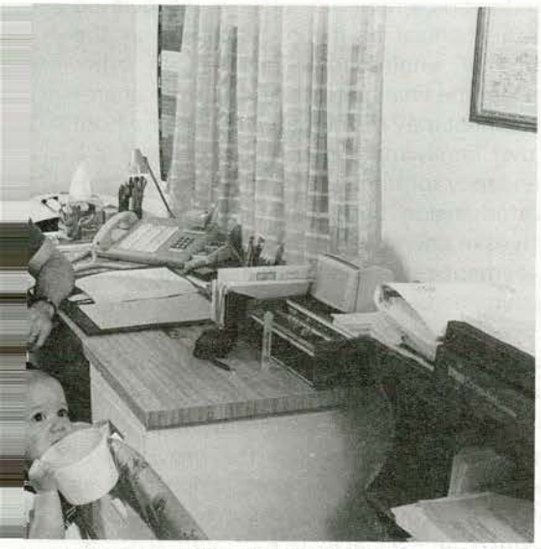
Job Security and Wage Flexibility

The structure and flexibility of national labour markets may be one reason why some economies (such as the United States) appear more dynamic and job-creating than others. An efficient labour market must meet the requirements of both employers and employees, providing employers with suitably skilled labour and giving workers a career that corresponds to their skills, their ambition for advancement and their desire for steadily improving living standards. In a time of rapid structural change, that also presupposes that the market must provide both opportunities and incentives to encourage the adaptability of the workforce.

One issue that arises in this respect is the question of the desirability of long-term employment arrangements. Much attention was paid to the phenomenon of labour market turnover in the 1970s, especially in the United States. In some countries, a high rate of turnover among some labour force groups is found to coexist with a high degree of relatively permanent job attachment elsewhere. The fact that long-term employment arrangements persist suggests that it is an economically efficient system, insofar as employers find it cost-efficient and workers appreciate the job security it affords.

Long-term jobs are held by a significant proportion of workers in OECD countries. Persons currently employed will, on average, have spent 23 years before they leave their existing employer in Japan, 17 years in most European countries and 14 years in North America. Austrialia has the shortest average tenure at 13 years. This is reflected in the fact that North America and Australia exhibit a high degree of labour market turnover in the form of shortlived jobs. In consequence, the average American worker, for instance, holds a larger number of jobs during his lifetime than his





opportunities. Skill levels vary greatly – from project engineering and consultancy to catering and certain social services.

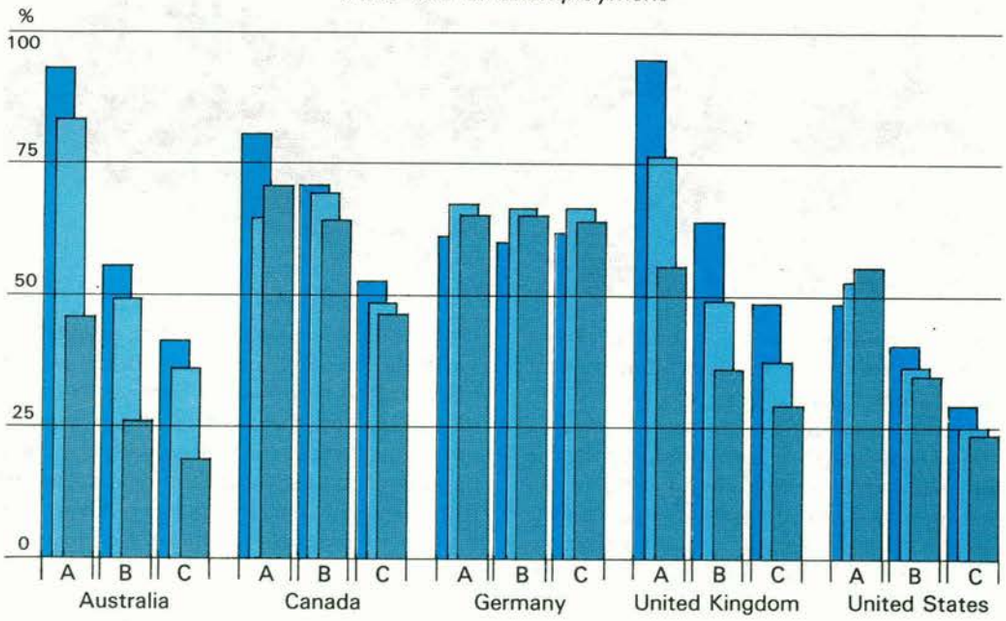
Japanese counterpart: while the typical Japanese male completes no more than 2.6 jobs during his life, the average American can expect to work in about 7.5 jobs. In fact, a Japanese worker completes as many jobs in a lifetime as an American worker can expect to have terminated by the age of 25.

The predominance of long-term employment arrangements can be attributed to a variety of factors, such as the level and specificity of skills, the structure of the production process, the social security system and general societal attitudes. On the other hand, arrangements between employers, trade unions and workers may generate a degree of rigidity in wage movements which is inefficient at the level of the macroeconomy. Relative wage structures appear to be more flexible in the United States and Japan than in Europe, for instance; rigid wage differentials in Europe have weakened the role of the price mechanism in promoting labour mobility and may thus have exacerbated the present structural unemployment problem.

Consider, for example, the case of young people. Because they have less experience than adults, they are likely to be less productive, and this is usually reflected in wage differentials. In some OECD coun-

C. INCOME REPLACEMENT RATIOS (a) BY FAMILY SIZE AND PREVIOUS EARNINGS

First Year of Unemployment



Legend:
Single person
Married couple
Married couple, two children

A Earnings before unemployment half average level
B Earnings before unemployment at average level
C Earnings before unemployment 1½ times average level

(a) The extent to which unemployment benefits replace income lost from unemployment.

Source: *OECD Secretariat calculations.*

There are strong equity grounds for positive discrimination in job creation programmes for the long-term unemployed and for sophisticated teaching programmes to combat youth unemployment.

tries, however, youth wages have increased more rapidly than adult pay, or have been inflexible downwards in response to labour supply pressures. This may, in part, explain why unemployment is typically higher among young people than among adults. In the seven largest OECD countries, the average youth unemployment rate in 1983 was 16.7 per cent, compared to 6.1 per cent for adults.

A major exception is the United States, which demonstrates the importance of downward relative wage flexibility in the youth labour market. Over the past two decades, young people have increased their share of the labour force at the same time as adult females have stepped up their participation. But because youth wages have shifted downwards relative to those of adults, and the relative labour market position of youth has improved, the high degree of wage flexibility in the United States may have been a factor reducing the burden of unemployment on young people.

Helping the Long-Term Unemployed

The prospect of high unemployment levels for many years to come, at least in Europe, has led governments to pursue policies which are designed not only to seek to relieve the burdens of the unemployed by way of income support, but also to facilitate their return to employment once jobs are available. This is particularly important as regards the long-term employed, who now account for 40 per cent of total European unemployment, compared to 27 per cent in 1979 (and to 13 per cent currently in North America). Indeed, work habits and skills tend to deteriorate if they are not maintained and employers, faced with an ample supply of job seekers, are often reluctant to hire from the ranks of the long-term unemployed.

Unemployment is closely associated with financial hardship, especially in the case of single-parent families. In other cases, the financial loss arising from unemployment may be mitigated by income from other family members, although there is a tendency for unemployment to be concentrated inside particular families (e.g the wives of unemployed men have high unemployment rates themselves). While unemployment benefits may go a long way to cover the income lost for the short-term unemployed, the position of the long-term unemployed is generally much worse.

The problem of long-term unemployment is more than just the provision of adequate income support, important as that is. It often leads to a loss of self-esteem and social isolation. Special efforts are needed by public authorities, employers, trade unions and the community at large to enhance their re-employment prospects. There are strong equity grounds for positive discrimination in labour market programmes in favour of the long-term unemployed. This may entail giving the long-term unemployed preferential access to programmes designed to help the jobless in general, such as public sector job creation schemes. Local employment initiatives could also do much to help by mobilising support among local authorities and communities to tackle the problems of the long-term unemployed, with the help of employers and trade unions. In the case of the older long-term unemployed, who face very severe job-finding problems, appropriate action may include provisions for early retirement.

*
* *

In sum, while the strength and durability of the recovery will be a crucial determinant of future employment prospects, there is a growing realisation that generating the required rate of new jobs to make major inroads into reducing unemployment will remain a serious problem in the medium term. In this time scale, it is not only the growth of output but also the impact of structural change that will determine employment levels.

Industrial Policies: Responses to a Common Core of Problems

by Irving Jaffe[1]

Policies designed specifically to help industry adapt to new conditions and perform more efficiently have become a significant feature of many governments' economic-policy arsenals over roughly the past twenty years. Most governments, of course, have always been involved in supporting certain industrial activities, either because of their strategic military or economic importance or for reasons of public welfare. But unprecedentedly rapid economic, social and technological change in recent decades has given rise to new needs for adjustment on a scale that industry has not always been in a position to effect unaided.

To begin with, the fast growth of the 1960s had a highly uneven impact on different industrial activities, and governments often acted to facilitate the adjustment of traditional industries (e.g., textiles and clothing) to considerably changed world market conditions. Moreover, as rapid technological innovation was an important driving force in this growth, governments sometimes saw a need to assist industry, or specific industrial sectors, in meeting the technological challenge to international competitiveness, or to support costly new technological developments in strategic areas such as nuclear energy and computers.

When the first oil shock in 1973 ushered in a prolonged period of general economic slowdown and dramatically accelerated structural change, government action directed to industry intensified considerably: at first, this involved, to a large extent, defensive actions to stem the rise of unemployment and the erosion of the industrial base; subsequently, the measures taken were conceived increasingly with a view to tackling the underlying structural problems that had become more clearly visible. At the present time of still fragile recovery, governments seem to be weighing the lessons of the very difficult decade behind them in order to see, with greater precision, how industrial policy measures might most effectively be devised and co-ordinated with macroeconomic policies to help improve the efficacy and flexibility of industry's response to rapid change.

The Nature of Industrial Policy: Different Country Approaches

Before looking at the main thrusts of present policies, it would be useful to ascertain to what extent a clear definition of industrial policy is possible, and to see how different countries pursue their objectives in this area.

Perhaps the first thing that strikes one is the difficulty of circumscribing the field of industrial policy simply by defining the types of policy instruments used. For while a government grant (or low-interest loan or tax concession) specifically designed to encourage, for example, investment in the modernisation of manufacturing plant or equipment is obviously an industrial policy measure, many other economic policy measures also have considerable impact on industry, even though this may not be their objective (or their sole or primary objective). As industrial activity is so intimately woven into the total economic fabric, illustrations abound: two examples are trade policy measures and government procurement, the latter including research and development contracts in areas such as defense and space, entailing potential spin-off effects that can enhance the international competitiveness of certain industries.

But while a broad range of economic policies in all countries has a direct or indirect impact on industry, there *are* nevertheless significant differences in the degree to which governments specifically formulate policies with a view to promoting the attainment of explicitly defined objectives concerning industry. These differences may stem, for instance, from differences in national economic structures, in the traditional role of government with respect to industry, and in the nature of the relations that obtain between government, industrial management and labour.

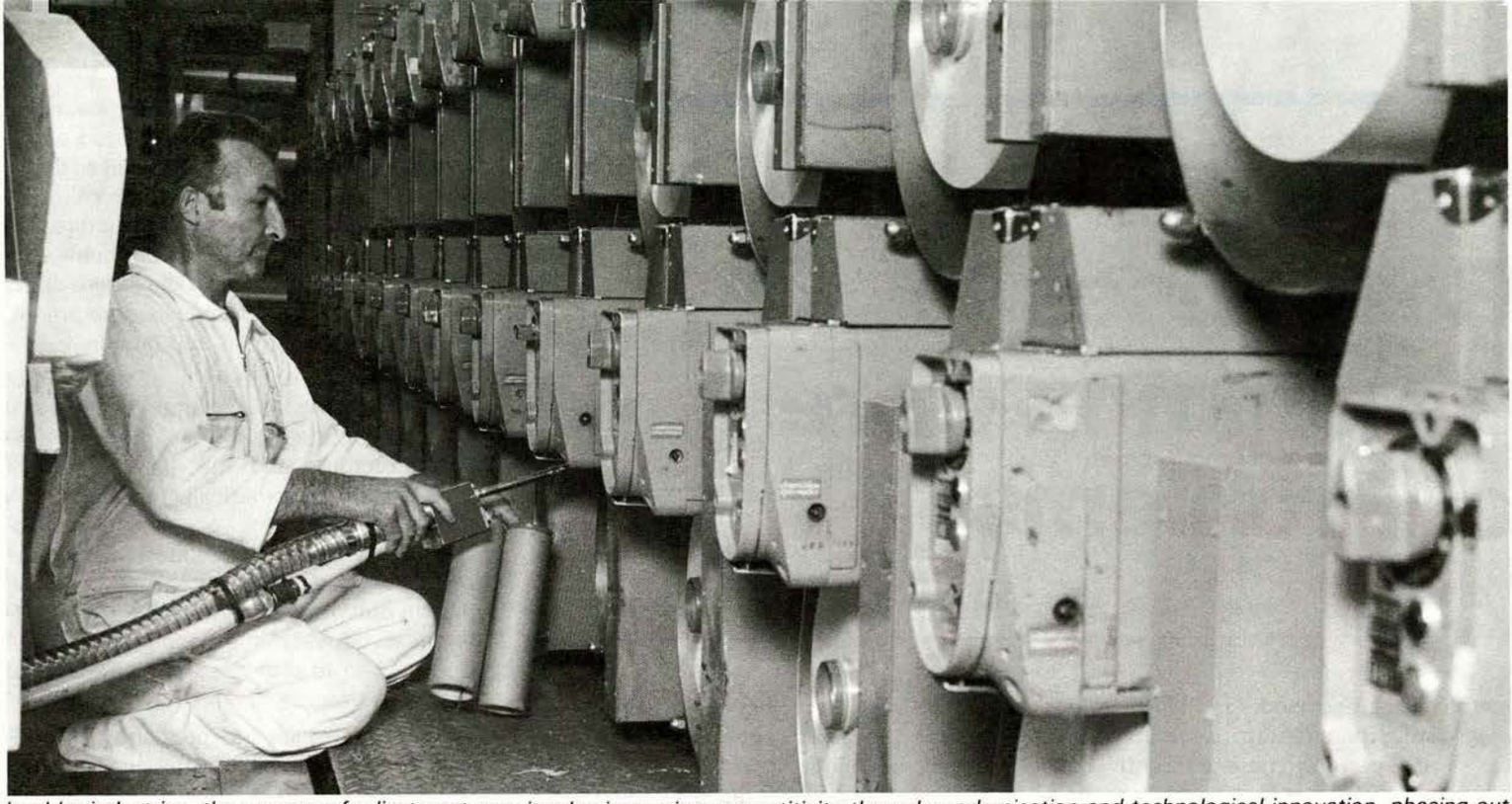
Clearly, countries with a tradition of indicative economic planning, involving objectives related to the evolution of industrial structures and the identification of priorities, do systematically formulate such policies, in the framework of their respective procedures for consultation with the relevant economic agents (e.g., France and Japan, notwithstanding the significant differences between these countries in the means used to promote the attainment of their objectives).

Moreover, quite independently of political or economic philosophy or traditions, the character of a country's industrial structure can constitute a strong determinant with respect to the role the State will play in relation to industry; for example, the particularly great vulnerability to the recession – and the consequent remedial policy actions – manifested by a smaller country such as Sweden with an economy highly exposed to external vicissitudes and an industrial structure specialised in sectors that were among the hardest hit (steel, shipbuilding).

Looking back from the rather precarious vantage point of the present "transitional" period, the events of the past decade seem to have had the effect of blurring somewhat the distinction between the more and the less active and systematic industrial policy approaches. On the one hand, the disruptions that marked that period made it more difficult to formulate clear longer-term objectives and *a fortiori* policies for attaining them. On the other hand, the prolongation of recession conditions seems to have induced some countries traditionally disinclined to systematic industrial policy-making to look more closely at problems of industrial structures – as well as, under the pressure of circumstances, to take limited sector- and firm-specific actions (e.g., the United States in the 1970s).

Perhaps the essential, positive, resultant of the decade's experience has been a clearer recognition that the role of industrial policy is to help remove structural rigidities and to promote the flow of resources to activities where they can be most productively employed. Although some of the defensive actions taken in crisis conditions may not have been avoid-

1. *Industrial Analysis Division, OECD Directorate for Science, Technology and Industry.*



In older industries, the process of adjustment may involve improving competitivity through modernisation and technological innovation, phasing out excess capacity and the introduction of new product lines. Above: a modern polyester plant run by Rhône Poulenc in France.

able in the circumstances (and may in some cases be very difficult to wind down), it has become increasingly evident that their prolongation means not only the perpetuation of an inefficient allocation of productive resources but also, perhaps, an unacceptable drain on public finances at a time of increasingly constrained government budgets. In that perspective, it is interesting to note that a number of governments of very different political complexions have made clear their resolve to promote an acceleration of industrial restructuring in their countries despite the difficulties of reducing the (largely employment-related) constraints.

Concerns for the Future

The problems of structural adjustment – which the recession has brought into sharper focus and has in many respects aggravated – cannot be expected to disappear with stronger growth. These problems have their roots in rapid economic, social and technological change, often already in evidence before the first oil crisis. Certainly, the present recovery, as manifested in the United States, Japan and a number of European countries will, as it proceeds, alleviate some of the constraints on improved allocation of productive resources. But serious structural maladjustments are certain to subsist; the maladjustments now faced by various economies are related to, e.g., constraints on adjustment of production capacities to changing market conditions, labour market rigidities or capital market deficiencies, inadequacies in the diffusion and application of technological innovation or managerial know-how. Moreover, the recovery itself could, through an uneven incidence on different countries and economic activities, be accompanied by new structural imbalances and new pressures on governments.

In the light of the foregoing, the OECD Industry Committee, in its latest annual industrial policy review, has drawn attention to a number of questions of continuing concern[2]; these policy areas may be described as follows:

1. Governments are seeking ways of improving their policy approaches to the encouragement of *investment,* particularly investment of the longer-term structural nature important for sustained recovery. In recent years, some countries have experimented with new ways of "fine-tuning" their policies in this area so as, for example, to address effective investment incentives to firms currently not in a position to take advantage of tax concessions based on profits or to weight incentives in accordance with priority objectives regarding types of investment. On the whole, however, relatively little is known about the efficiency of different types of investment incentives under different conditions. It should be added that attention is increasingly being directed to ways of stimulating the provision of *risk capital* (particularly for smaller firms and new ventures), which is important to industrial revitalisation but for which adequate financial mechanisms are lacking in many countries.

2. As governments have set about reassessing the defensive measures taken in crisis conditions, and looked to more adjustment-oriented objectives, they have given increasingly high priority to policies for encouraging improved responsiveness by industry to *new technological challenges and opportunities.* The intensified emphasis on technology is reflected in part in support for high-technology industries, because of the key role they may play in the modernisation of the economy as a whole, but also for balance of payments, strategic or national prestige reasons. High technology products now represent a very substantial, and in most countries growing, share of the industrialised nations' trade in manufactured goods. Hence, the significance, from an international viewpoint, of the policies pursued by the public authorities in this area and their effects on trade, as well as the effects of the activities and strategies of the enterprises concerned.

Governments are also showing a growing concern with the degree to which technological innovation is being *diffused* so as to improve the competitive position of firms throughout a country's industrial structure, particularly the smaller firms and companies in traditional industries. They have set up numerous schemes for increasing management's awareness of innovations (notably micro-electronics applications) and its capacity for applying them. This is part of a larger concern on the part of governments to promote not only the accumulation and modernisation of capital stock, but its optimal *utilisation.* At the same time, the societal impacts of technology are the subject of increasingly intense examination – notably the complex questions, of profound policy significance, related to the short- and long-term

2. Current Industrial Policy Issues and Recent Developments in Industry, 1984, available from OECD's Directorate for Science, Technology and Industry.

employment implications of technological innovation.

3. Continued, indeed stepped-up, *adjustment* clearly seems necessary in a number of *mature industries* in the OECD area. There are wide differences in the ways governments view their role with respect to the adjustment process, as well as in the situations of specific industries in different countries. But it can be said that adjustment in these sectors may involve improvement in competitiveness through modernisation and technological innovation, phasing-out of excess capacity, shifts to new product lines.

The degree of adjustment effected in the mature industries has varied among different countries and sectors. Employment considerations – often rendered politically more sensitive by concentration in certain regions – are clearly a constraint, underlining the importance of efforts to find effective as well as socially acceptable means of manpower adjustment. In addition, the objectives of some countries – particularly with regard to basic industries – include a desire to maintain certain capacity levels in order to avoid erosion of the industrial base or loss of international competitive potential in the event of a vigorous economic upturn. There seems to be little doubt, however, that structural factors (in particular, shifts in the composition of demand in advanced economies and the transfer of production capacity to non-OECD areas enjoying cost advantages) will require a further "streamlining" of mature industries, in ways and to degrees that will vary according to the sectors and countries concerned. As the Industry Committee noted in its latest review of industrial policies, relaxation of the process of adjustment in these industries could:

- endanger recovery by hindering the movement of resources to more productive uses
- aggravate problems of overcapacity and exacerbate trade frictions between countries, thus adding to protectionist pressures and to the danger of retaliatory defensive measures
- bring about a decline in the competitiveness of existing capacity.

4. In some countries there has been a new look at the relations between industry and the government. One direction that has been taken in this context consists of the relaxation or dismantling of regulatory provisions in order to relieve the cost burden on industry and remove obstacles to its development and efficient performance. *Deregulation* has been one of the top priorities of the present Administration in the United States, and has received considerable implementation in that country. More recently, some other countries (e.g., the Netherlands, Germany) have indicated that deregulatory action is part of their policy strategies as well. Deregulation – like the *privatisation* of nationalised or other publicly owned enterprises, which is of particular importance in the United Kingdom – may be regarded more broadly as part of a policy option to reduce the government role in industry and to harness market forces more fully.

An important issue that may arise is the possible competitive impact of differences between countries' regulatory policies that result from differences in the relative weight given to the various societal goals (environmental protection, consumer protection, etc.) that lie behind regulatory actions. It should be added that certain types of legislation or regulation may have negative "external" effects – across national frontiers.

5. Industrial policies, which have their own appropriate objectives – essentially the promotion of more adaptable and efficient industrial structures – cannot of course be considered exclusively from the point of view of their interface with *trade* questions. This having been said, it remains true that the impact of industrial support or promotion policies on international trade, and the influence of trade measures on industrial development and structures, have increasingly become issues of international concern. The question of the possible trade impacts of policies promoting high technology products as well as of policies in support of mature industries has been alluded to above. In this connection, it may be noted that the OECD Council at Ministerial level has agreed that the economic recovery, as it proceeds, provides favourable conditions for the relaxation and dismantlement of both trade restrictions and trade-distorting domestic measures, and has approved a programme for working out specific proposals for individual and collective actions to that end.

Strenghthening International Co-operation on Investment

Problems that have arisen between governments – or between governments and foreign investors – over international investment are important economically and sensitive politically. OECD has played a pioneering role in the difficult area of resolving such problems. As early as 1961, Member countries adopted a Code of Liberalisation of Capital Movements *which calls for progressively abolishing restrictions on movements of capital between countries. In 1976, Member countries issued a joint* Declaration on International Investment and Multinational Enterprises. *The aim of these legal instruments is to improve the investment climate, to encourage multinationals to contribute to economic and social progress and to minimise the problems that may result from their activities. Recently these agreements have been strengthened and amended to address new foreign investment issues.*

Code of Liberalisation of Capital Movements

First, the commitment under this code to progressively abolish restrictions on international capital movements, including those on foreign direct investment, has now been accepted by all Member countries. The most recent adherent to this code is Canada which announced its decision at the May 1984 Ministerial Council meeting.

Second, the code, which has always covered restrictions on foreign direct

investment, has been amended to extend its coverage to several types of regulations, particularly relevant in the services, under which foreign investors have been subject to special requirements if they wish to operate in any given country. Banking authorities, for example, require that branches or subsidiaries of foreign banks be licenced. Such regulations – broadly termed regulations relating to the "right of establishment" – have now been brought within the scope of the code when they impose more stringent requirements on foreign investors than on domestic ones. The amendment, which was endorsed by OECD's Council at Ministerial level in May, is a step in the direction of liberalising international trade in services: in many cases a subsidiary or branch must be established if such services are to be provided effectively in the country concerned. Member countries have also undertaken a commitment to encourage states, provinces and other entities within their borders to adopt a similar liberal stance.

The 1976 Declaration on International Investment and Multinational Enterprises

This Declaration has three parts: *guidelines for multinational enterprises; the principle of "national treatment"; an agreement on incentives and disincentives.*

Each of these instruments is reinforced by an OECD Council Decision, embodying procedures for notification and consultation.

A review of the Declaration by OECD's Committee on International Investment and Multinational Enterprises (CIME), approved by OECD Ministers at the May 1984 Council meeting, strengthens this declaration and the related decisions in several respects[1].

Guidelines for multinational enterprises

These embody recommendations by OECD governments to private firms that operate internationally and represent governments' expectations as to how these firms will behave. These guidelines also refer to the desirability of avoiding situations in which multinational enterprises are submitted to conflicting requirements by OECD governments.

The agreement on *conflicting requirements* imposed by governments on multinational enterprises have been reinforced to address problems which have arisen in recent years when the laws of the parent country of a multinational have required a subsidiary to do something which ran counter to the laws of the country in which the subsidiary was located. Obviously, such conflicts can hamper the flow of international investment, technology and knowhow and damage the investment climate. Ministers have agreed that, when a country is contemplating new legislation that could give rise to such conflicts (or contemplating action under existing laws), they will exercise moderation and settle their conflicts on a bilateral basis or bring them before OECD's Committee on International Investment and Multinational Enterprises.

The Guidelines have also been amended so that *consumer interests* will be taken more specifically into account by multinational enterprises.

The review strengthens the guidelines by examining them in the light of *structural adjustment* problems. It indicates that the global employment performance of multinational enterprises has been at least equal to and in some cases superior to that of domestic firms: multinationals do not have more frequent recourse to closure of plants, subsidiaries or branches than do their domestic counterparts. Yet, the review goes on to add, actions of multinational enterprises may differ from those of domestic firms because of their international character and the fact that they operate across national boundaries, and these differences affect the nature of decision making. In particular, there are political sensitivities when restructuring decisions are taken at head offices located outside the jurisdiction of the country concerned. The review calls attention to the request, written into the 1976 Guidelines, that multinational enterprises give "due consideration to the aims and priorities with regard to economic and social progress of the Member countries in which they operate".

If multinationals wish to centralise decision making – as modern technologies permit them to do – their subsidiaries may become less autonomous and sometimes less responsive to local conditions. The review stresses that multinationals should nevertheless give their subsidiaries enough resources and responsibilities so that they can remain integrated into the economic context of the host country.

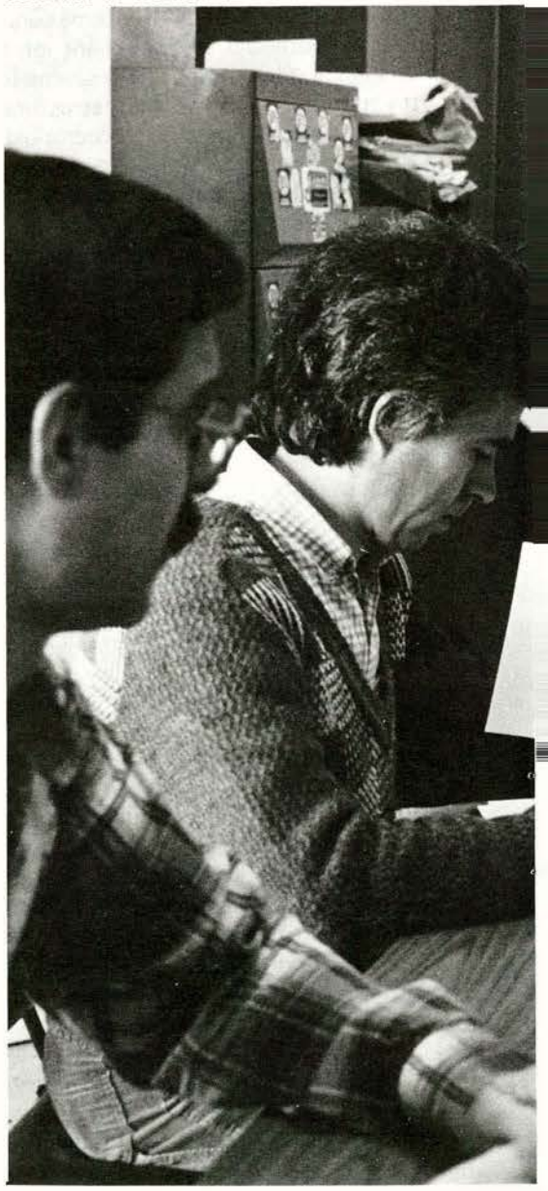
Other issues closely related to structural adjustment are also clarified by the report. It has sometimes been claimed that inadequate information has been provided to trade unions in connection with decisions to close or transfer activities. Trade unions' access to managers having the authority to take decisions has also been seen as a problem. The guidelines' recommendations have been clarified on these points. Also, in some cases it has been reported that the right of employees to be represented by trade unions has not been respected, and that there have been active efforts to discourage organising activities. The review clarifies the Guidelines covering these situations and notes that their thrust is to have management adopt "a positive approach towards the activities of trade unions and an open attitude towards organisational activities of workers".

National treatment

According to the principle of national treatment, foreign controlled enterprises established in an OECD Member country should not be treated less favourably than domestic ones in like situations. This principle covers all activities of such enterprises, and implies, for instance, that a foreign subsidiary should be able to expand its activities in sectors other than the one in which it was originally established.

When the national treatment instrument was adopted, most OECD countries registered so-called "exceptions" to the principle – cases in which they would not be applying national treatment. Now these exceptions will be submitted to periodic

The review encourages management to adopt "a activities of workers".



examination by the Committee with the aim of extending the application of national treatment to more OECD countries and situations. An extensive survey of these exceptions was made this year by the Committee on Multinationals in order to bring greater transparency in this complex area[2]. Most of the measures reported in this survey fall within three areas:

- *Investment by established foreign-controlled enterprises.* Most Member countries have exceptions in this area. Such sectors as air and maritime transport, mining and natural resources, banking, insurance, broadcasting and publishing are those in which discrimination is most frequent. About half of the Member countries require prior authorisation for further investment in these areas, including takeovers of existing firms.
- *Government procurement and public purchasing.* This is the area in which exceptions to the principle of national treatment pose the most problems, with about fifteen Member countries reporting unequal treatment, most frequently in defence and defence-related procurement. In addition, practices of a discretionary nature and arcane procedures in awarding public contracts often make competition difficult for foreign-owned firms and increase their perception of encountering discriminatory treatment.
- *Government aids and subsidies.* Official financial and other assistance to business firms can be given in the context of a variety of policies including demand management, employment and industrial policy, promotion of research and development and regional development. Fifteen Member countries have reported discrimination – in support of the tourist industry for instance – and preferential treatment of domestic oil and gas companies (the latter are among the most troublesome from the business point of view). Credits for new plant and equipment and grants for research and development, if applied on a discriminatory basis, can also have a significant economic impact. Aids and subsidies extended by a government in its capacity as a shareholder of public enterprises are not generally considered to be covered by the provisions of OECD's national treatment instrument, but the financial relations between governments and publicly owned firms in the competitive sector are not always very transparent, and this lack of transparency may give rise to the suspicion that discrimination is being practised. Other matters in which discrimination exists but apparently with a lesser impact include taxation and access to local bank credit and capital markets.

positive approach towards the activities of trade unions and an open attitude towards organisational

Incentives and disincentives

This agreement provides that Member countries should give due weight to the interests of other countries when granting incentives and disincentives to international investors.

It has been strengthened as a result of the 1984 Review in that the consultation procedures provided for now have a wider scope. Previously such consultations covered only measures specifically designed for international investment. Now all measures are covered if they affect international investment, whether or not they were so designed. If for example host countries are too demanding on the amount of employment required of foreign investors, the local content or the percentage of production to be exported, and if this harms the interests of another OECD Member country, the latter can bring the matter before OECD's Committee on International Investment and Multinational Enterprises, even if the requirements also apply to domestic firms.

New Horizons

Foreign direct investment in developing countries will come to the fore in future work of OECD's Committee. An extensive work programme on this subject was proposed in the 1984 Review and accepted by Ministers including the analysis of trends in such investment and the determinants and effects on home and host countries' economies. In addition, ways will be explored for interested parties and experts, from both inside and outside the OECD area, to exchange views on investment issues of common interest, the ultimate aim being to find positive, balanced and mutually acceptable means to promote direct investment flows to developing countries and to further their contribution to economic development.

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1. *This report has been published under the title* International Investment and Multinational Enterprises, 1984 Review of the OECD Declaration and Decisions.

2. *A forthcoming report, to be published under the title* National Treatment *will include this survey. The 1984 Review of the Declaration contains a summary.*

Can Competition Policy Help Fight Protectionism?

Competition policy seeks to ensure the efficient allocation of resources by means of open and competitive markets, and thus is aimed at the removal or control of anticompetitive practices, including barriers against the access of foreign firms to domestic markets. In this way, it has been one of the building blocks in the development of an open and dynamic international trading system since the Second World War. However, the increased resort to "managed trade" and to other forms of protectionism in recent years constitutes a threat to the viability of this system. Such measures, which reduce or eliminate imports into markets, may reduce or impair competition in domestic markets and this is of concern for competition authorities. The study on this subject just carried out by OECD's Committee of Experts on Restrictive Business Practices has two objectives: increase the understanding of the interplay between competition and trade policy; examine the ways in which effective competition policies can help resist the resort to protectionist measures[1].

The situation is examined from two sides. First, consideration is given to practices by enterprises which have implications for competition and international trade, e.g., export and import cartels and other forms of export restraints, trading companies, restrictions in technology transfers and intra-group arrangements within multinational enterprises. The involvement of governments themselves in commercial activities through procurement, public enterprises and the regulation of industries is also looked at. The following main questions are addressed: To what extent do practices by enterprises act as substitutes for trade barriers? What is the relationship of such practices to trade policies pursued by governments? Are they reactions to imposed trade restrictions by governments? Are they condoned, encouraged or even compelled by government action? Do competition laws apply to those practices and, if so, are there any specific problems of enforcement in these areas?

Secondly, the study considers the impact of government trade policies on competition in national and international markets, including export controls, export promotion policies and quantitative restrictions. Specific laws dealing with unfair trade practices, e.g. anti-dumping and countervailing action, are also examined.

Finally, some of the problems that arise from the inter-action of international business conduct and government trade measures are investigated as well as the procedures that currently exist for cooperation and consultation between competition and trade authorities at the national and international level.

Practices by Enterprises Affecting International Trade

Export cartels and similar arrangements

Between the two world wars, export cartels were one of the major vehicles for conducting international trade, controlling from 30 to 50 per cent of world trade just prior to World War II. These international cartels provided a means for producers and manufacturers of different nations to divide and allocate world markets. By joining together, firms acquired collective market power, enabling them to foreclose competitors from their markets and to control prices, output and sales. After the War, as competition laws were passed in more and more OECD countries and through enforcement actions brought in the United States, most of the international cartels were broken up.

But countries seeking to strengthen and expand their exports have allowed domestic firms to enter into cooperative arrangements for foreign trade so as to achieve efficiencies of scale and to spread high risk capital outlays. Not all cooperative arrangements among export firms are considered to be export cartels, but only those which seek to restrain competition through cartel-like behaviour. Cooperative arrangements among export firms may enhance competition in foreign markets if they enable small firms which could not otherwise do so to engage in trade, and they have generally been exempted from competiton laws in the exporting country, if they do not affect domestic markets.

Nonetheless, while such cartels may be part of the export promotion policy of one country, they may be, and in some cases have been, challenged under the competition laws of the countries to which they export, reflecting a concern on the part of the importing country about the trade-distorting and competition-restricting effects of such arrangements. Thus there is a potential for conflict between the trade policies of the country that allows or encourages the export cartel and the competition laws of its trading partners. At present, Germany, Japan, the United Kingdom and the United States, require or provide for the notification of export cartels to the competition authorities. OECD's report suggests that governments which do not already do so should consider requiring that the competition authorities be notified of such cartels. Furthermore, firms participating in exempted national cartels should be made aware that their conduct may still infringe the competition laws of other countries. Governments of the countries where export cartels are located should also be ready to cooperate, as far as their laws permit, with the competition authorities of the countries affected in investigating the possible anti-

1. Competition and Trade Policies: Their Interaction, *to be published in the autumn.*

competitive effects of such arrangements.

Import cartels

Import cartels are agreements between firms in a particular country made for the purpose of coordinating the importation into that country of a good or service. In some cases, co-operation between importers can enable small firms to share costs and obtain economies of scale and rebates, and such cooperation may not be harmful to competition. The import cartels which may pose a problem are those which limit competition with respect to imports by co-ordinating the price, quantity and other terms of purchase with a view to the acquisition and exercise of market power either in the purchase of the goods abroad or in their sale in the domestic market.

The members of such a cartel will be able to restrict supplies and raise prices on the domestic market. Consumers will pay more, competitive pressures will be blunted and foreign suppliers denied access to that market through other channels. In such instances, both trade and competition in the domestic market can be restricted. Moreover, if the cartel members have sufficient monopsony power, they may drive the price of the imported product below what it would have been in a competitive market. As a result, the exporting nation will also suffer: both quantity exported and price will be reduced. Nor will the benefits necessarily accrue to domestic consumers but more likely to the cartel itself. On the basis of available information it would seem that import cartels do not present serious problems as regards manufactured products. However, there is some evidence such cartels have occurred in the raw materials sector. The increasing cross-penetration of developed countries' markets suggests that the conditions for an import cartel to be established and sustained will not be very commonly realised; and where they are, the cartel is likely to come to the attention of the competition authorities in the importing country.

Import cartels are generally treated by competition authorities in the same way as other agreements to restrict supplies and fix prices and are subject to competition laws. However, in some cases cartels which are considered necessary to offset or "countervail" sellers' market power are exempted or approved as in the United Kingdom, Germany and Spain. But, even in the absence of express legal provisions, the competition authorities may adopt a flexible attitude to import cartels. Thus in the United States, the Department of Justice indicated in the early 1970s that action would not be taken against U.S. oil companies which dealt collectively with the OPEC oil-producing cartel. By 1974, however, the Department had indicated that, because of changed conditions in the oil market and its own concern about the competitive behaviour of the U.S. oil industry, such immunity would no longer be assured.

OECD's report suggests that, if exporting countries inform the competition authorities in the importing country when they suspect the existence of an import cartel, the importing country should take apropriate steps to ensure that the cartel members are not in breach of its own laws and should co-operate, to the extent their laws permit, to minimise the adverse effects of its importers' actions on international trade.

Trading companies

Trading companies, which buy and sell products rather than producing them, have come to the fore in recent years. They vary in size and structure, many having been set up to channel imports and exports of a particular product on behalf of small and medium-sized enterprises. In Japan, however, a few general trading companies engage in many sectors of activity in addition to buying and selling. The most widely-known are the nine "sogo shosha" that employ over 50,000 persons and operate worldwide[2]. They are involved in all aspects of trade, providing access to

2. *A book on this subject, entitled* Japan's General Trading Companies: Merchants of Economic Development *is to be published shortly.*

The *OECD Observer* asked Lawson A.W. Hunter, Assistant Deputy Minister (Bureau of Competition Policy), Canada, and chairman of the Working Party on Trade and Competition of OECD's Committee of Experts on Restrictive Business Practices, why this study was carried out, what its main thrust is and where it might lead. His comments follow:

"This study reflects a concern on the part of many people in government – and outside – that the movement toward trade liberalisation has been stalled by countries adopting bilateral and other trading mechanisms which fall outside the ambit of the GATT and other multilateral trading agreements. Not only are governments engaging in protectionism but private cartel-like arrangements can prevent the efficient movement of resources between countries.

Competition authorities are concerned that they are not playing as significant a role as they might in preventing restraints to trade on an international scale. Competition policy authorities are in a good position to keep the philosophical underpinnings of free trade alive in a protectionist world. Therefore, part of the impact we hope for is on the trade policy makers.

We want to move toward an open world economy based on the same principles as competition policy at home. Within countries, competition policy is concerned with removing impediments such that resources are free to move to where they can achieve the best results and on the international scale. It is the geopolitical mechanisms of trade liberalisation that facilitates the efficient movement of goods and services. Thus competition policy and trade policy flow from the same principles.

First, we should like to arrive at some policy principles that the OECD could endorse. For example in facilitating export cartels we may be engaging in beggar-thy-neighbour activities which, even if they do not reduce competition at home, may do so in other countries. Our concern is that governments are under great pressure in the short term to reduce imports. Restricting imports diminishes international competition and hence involves a cost to domestic consumers and can harm the structure and competitiveness of protected industries. We would like to put some transparency into the process so that the second and third order costs of the protectionist measures become evident. What we need is a generalised cost-benefit analysis, which hopefully would become institutionalised as part of the decision-making process involved in international trade.

Second there is an analytic response. We should intend to study specific sectors to asses the impact on competition of voluntary export restraints and other non-tariff restrictions. In this way we will carry out the kind of competitive analysis we do at home in the international context.

Third, there is a concern about the effect on competition of antidumping and other laws against unfair trading practices. We think these laws can have the effect of increasing protectionism and thus have some very harmful effects in domestic markets because they can rigidify anti-competitive structures. The administration of these laws may be harmful to domestic industries, not to mention the international trading system."

*

Trading companies can expand the opportunities for trade but as they become increasingly prominent their effect on competition must be considered. Above: the activities of Japan's nine "sogo shosha" go far beyond simple buying and selling, as is evidenced, for example, by the shipping interests of Mitsui O.S.K.

distribution networks, arranging international joint ventures, transportation and financial services. They often have interlocking directorates with, or partial ownership of, a wide variety of manufacturing firms (though since 1977 there has been a limit on such holdings).

Trading companies can expand the opportunities for trade by providing specialised skills and services, financing, etc. to enable export firms, and in particular small enterprises, to enter foreign markets and thereby stimulate competition. On the import side, trading companies can provide distributional efficiencies, increase access to markets and thus strengthen the competitiveness of the foreign firms providing these imports. Moreover, they have a role in countertrade. Consequently, some countries are encouraging the formation of trading companies, especially on the export side, as a means to promote trade. For example, the United States has recently implemented legislation which makes it possible to grant export trading companies immunity from US competition laws and facilitates expansion of their financial base. Trading companies also seem to play an important role in Australia, Austria, Canada and Ireland, particularly for trade in agricultural and dairy products and in raw materials.

But as trading companies become increasingly prominent in the export and import trade of Member countries and product groups, OECD competition authorities must consider their effects on competition. In some instances, particularly where they are of a size to attain a dominant position in a market, trading companies may exercise their market power in a way that reduces competition. For example, on the import side, one or more trading companies may effectively control distributional networks and, if they abuse their power by discriminating against foreign producers, can lessen competition and restrain trade. Concern has also arisen because of their diversification through interlocking directorates and acquisition of interest in other firms.

In Japan, the Fair Trade Commission recently concluded a study on the competitiveness of national distribution networks for imported goods and the role of trading companies in distribution. The report concluded, among other findings, that imported goods are not treated unfairly as compared to domestically produced products. The Fair Trade Commission will continue to monitor the activities of trading companies to ensure that they do not infringe the provisions of Japan's Anti-Monopoly Act. Given the power of trading companies, in particular geographical and product markets, OECD's report notes that governments should closely follow the growth of these companies, and, where appropriate, should apply their competition laws to any anti-competitive practices in which they engage.

Voluntary export restraints (VERs)

In recent years there has been a growing use of voluntary export restraints to control or limit imports and to protect domestic industries from foreign competition, especially in steel, automobiles, footwear and consumer electronics. Although generally conceived as an instrument of trade policy, the effects of VERs can resemble those of export cartels and thus they are of concern to competition authorities. VERs may be arranged formally between governments (in which case they are usually termed orderly marketing arrangements or OMAs) or between individual firms, with or without government sponsorship.

Perhaps the most widely-known VER is the arrangement between the United States and Japan entered into in 1981, under which Japan limited its auto exports to the US to 1.68 million a year for three years. The Japanese government decided as a temporary measure to continue the restriction in 1984. In early 1983, Japan for the first time decided to exercise export restraint for particular products for the Common Market. This moderation took the form of a series of official forecasts of specified Japanese exports to EEC countries. In the case of videotape recorders (VTRs) the arrangement spells out not only the number that Japan will sell in the EEC but also sets a floor price and provides that there will be a market for a specified number of units produced by European manufacturers. Colour T.V. tubes, light commercial vehicles, forklift trucks, small motorcycles, quartz watches, stereo equipment and machine tools are also subject to similar arrangements.

Other VERs reported to OECD's Committee on Restrictive Business Practices (in answer to a questionnaire on which the present study is partly based) include a 1982 agreement in which the United States requested that its major suppliers of beef and veal – Canada, Australia and New Zealand – agree to limit their shipments to the US as an alternative to a process that might lead to quotas. The U.S. also has VERs (or orderly marketing arrangements) for colour T.V. receivers, non-rubber footwear (Korea, Taiwan), carbon-steel products (the EEC), cotton (Egypt) and machine tools (Japan). British firms have reached understandings related to orderly market practices with firms in supplying countries in such sectors as vehicles, footwear, cutlery, consumer electronics and pottery.

One problem with VERs is that their status is uncertain either under international trade agreements or national competition laws. As can be seen from these above examples, VERs generally arise as a result of pressure or requests from the importing country and may be regarded by the exporting country as preferable to other, more restrictive trade barriers. Since a VER is arranged with a single country that exports a given product, while other countries or firms exporting the same product are not affected, it can be said that VERs are generally applied on a selective or even discriminatory basis. Although VERs can produce cartel-like effects, they may not be subject to challenge under restrictive business practice laws – either because they fall outside the jurisdictional limits of these laws or because they are encouraged, imposed or directly implemented by govern-

ments. This has facilitated their increased use and raised some difficult issues for both trade and competition authorities. As they lessen competitive pressures on domestic producers, VERs may entail a substantial cost to both consumers and the economy of the importing country. Moreover, they may have detrimental effects on countries not party to the agreement.

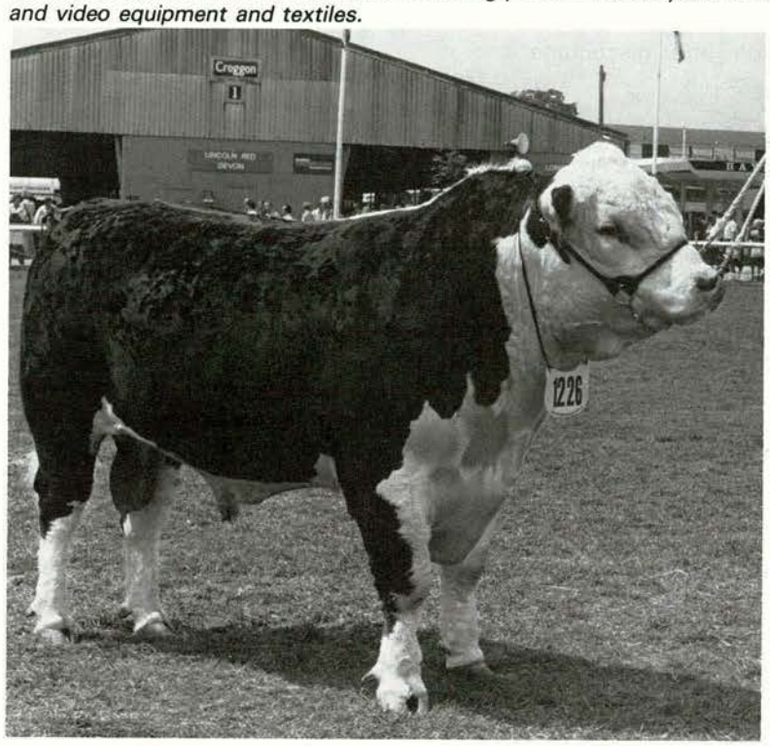
Yet, in the OECD, only Finland and, under certain circumstances, the United Kingdom require that the competition authorities be notified of voluntary export restraints. OECD's Committee of Experts on Restrictive Business Practices suggests that notification of private VERs would facilitate enforcement of competition law on these arrangments. Not only greater transparency but monitoring of the effects of these restraints is required, the Committee suggests. Bringing VERs under international surveillance and control would be a first step in regulating their use in a manner consistent with an effectively functioning international trading system.

Countertrade

Countertrade, in which the seller must accept goods or services in payment for goods exported[3], began in the 1970s in East-West trade and has recently spread to the developing countries. There is a lack of transparency in such deals: they may conceal export subsidies, sales at dumping prices and more favourable financial terms than those allowed under multilateral rules. Countertrade has enhanced the role of trading companies which offer services to small-sized exporters lacking the expertise to distribute goods received in countertrade. OECD's report notes that countertrade threatens the open multilateral trading system by emphasizing reciprocity rather than price and quality as the criteria

3. OECD includes in countertrade:
- *barter, counterpurchases and their variants*
- *buy-back agreements and arrangements for the reciprocal exchange of goods under industrial cooperation agreements*
- *switch operations and those linked to sales of military equipment.*

Voluntary export restraints have been increasingly used in recent years to control or limit exports of such diverse products as livestock, motor cycles, TV and video equipment and textiles.



for the exchange of goods and services and by closing markets to competition (especially in the case of long-term arrangements requiring exchange of fixed quantities of goods without reference to price).

OECD countries have not adopted competition laws specifically covering countertrade but, in their response to OECD's questionnaire, governments indicated that countertrade would in principle be subject to their competition laws (since there is no basis for distinguishing it from other trade practices). No cases have actually been brought by the competition authorities to date. Countertrade goods also may be subject to review under anti-dumping and other unfair trade laws. Because of their potentially harmful effects on trade and competition, their uncertain status under competition laws and their growing role in world trade, such agreements should be kept under review, the OECD's report concludes. Above all they should be made more transparent.

Multinational enterprises and intra-firm agreements

Intra-group trade between parent companies and affiliates of multinatinational enterprises has come to account for a substantial share of total international trade, almost 40 per cent of total imports for the United States (including transactions between U.S. affiliates of foreign-owned multinationals and their parent companies) according to a recent United Nations publication, and 30 per cent for the United Kingdom. A third of all parent company exports may consist of intra-group sales. Given the size of this intra-group trade, the arrangements are of interest to policy makers since they may conflict with the policies of host countries and affect trade flows. The report examines, in particular, intra-group allocation of markets and products, transfer pricing and cross-subsidisation.

- *Intra-group allocation of markets and products*

Multinational enterprises often operate through subsidiaries or affiliates, which are legally distinct entities, some only partially owned. In the course of business, multinationals may make internal arrangements with these subsidiaries or affiliates which restrict the range of products the latter can produce or the markets they can serve. This can be done either directly by imposing restrictions on export or production or on patent and trademark licensing or, indirectly, by imposing restrictive terms and conditions of delivery or restrictive procurement policies (including obligations to buy essential raw materials or semi-manufactures).

Such allocation of tasks may be necessary to maximise performance of the group as a whole but may give rise to concern in both home and host countries, particularly where MNEs hold a sufficient share in markets to significantly influence trade flows. A recent study by Statistics Canada, for example, found that, in almost all sectors of the Canadian economy, the reliance of foreign-controlled firms on imports was much greater than that of their domestic counterparts. Other host countries have noted that export restrictions imposed by parent companies on their subsidiaries may conflict with their export promotion policies.

Some host countries have found it necessary to impose export or local-content requirements on foreign-controlled enterprises to counteract intra-group restrictions, but such requirements, if used in a systematic way, may in themselves distort trade and competition and discourage investment.

- *Transfer pricing and cross-subsidisation*

The prices charged for intra-group transfers may diverge considerably from the prices that would have been agreed upon between unrelated parties (so-called "arm's length prices"), and sales proceeds may be transferred from one product line or geographical area to another (cross-subsidisation). These practices are inherent in the operations of companies having different levels and cycles of profitability. Yet both practices may be abused, although the fact that transfer pricing policies are subject to control by national tax, customs, or exchange control authorities, may significantly limit the scope for abuse.

Factors beyond the control of multinationals such as cost differences between countries also tend to produce price differences, and these must be distinguished from cost and price differences caused by abusive pricing practices. An example of abuse is to be found in a recent decision of the French competition authorities. In order to restrict competitors' market access, a multinational pharmaceuticals group, which held a dominant position in the relevant product market, charged low prices for the products of one subsidiary and made up for it, at least in part, by charging artificially high prices for largely identical products sold by another subsidiary to a different category of customers.

In most OECD Member countries, intra-group practices are not considered in themselves harmful unless they amount to an abuse of a dominant position adversely affecting competition outside the affiliated enterprises. It has generally been recognised that requiring individual entities within a single economic enterprise to compete, could discourage internal growth and decrease efficiency of the multinationals and also create enforcement difficulties for competition authorities. A challenge to internal allocation and pricing practices within a multinational, as in a domestic group, is more likely to be based on abuse of a dominant position if the firms involved hold sufficient market power to warrant such action. Applying national legislation to intra-enterprise practices by multinationals, however, presents several difficulties. Establishing the burden of proof, collecting documentation and other evidence located abroad and exercising jurisdiction over foreign firms or persons all complicate enforcement actions. And relief requiring behavioural or structural change of the foreign enterprise may be difficult to enforce and give rise to enforcement problems and disputes as to national sovereignty.

Government commercial activities and regulation

The involvement of governments in commercial activity has a significant impact on competition in domestic markets and on international trade. This involvement can arise through government procurement policies, public or government-owned enterprises or through government regulation of industries. In each of these areas, concern arises as to whether government activity operates either to discriminate against foreign firms or to invest domestic enterprises with unfair competitive advantages. While the commercial activity of governments is generally subject to competition laws, there are often difficulties in applying such laws to these activities.

Regulated sectors are those in which it has been deemed socially desirable for governments to set such conditions as price or output rather than to rely on market forces. Efforts to increasingly apply competition laws to regulated sectors have proved beneficial in the view of several countries. Deregulation may however cause problems in trading with countries where regulation remains the rule. To improve this situation, co-operation between government authorities, including those responsible for competition policy, is necessary.

Trade Policy Measures Affecting Competition

The study also examines on a more general basis the other side of the coin i.e., the impact of government trade policy measures on competition in domestic and international markets. The competitive impact can be significant. Where such measures restrict the pro-competitive effects of international trade in markets in terms of price, quality and incentives to innovate new products and production

processes, they are of direct concern to competition policy authorities. In some cases restrictive trade measures can be conducive to increased collusion between market participants. In the long run, measures designed to shelter sectors from the incentives resulting from effective competition can reduce the ability of these sectors to innovate and grow in the domestic economy and to compete internationally, even though the stated purpose of the measures may be to give the sector time to adjust and become more competitive.

Non-tariff restrictions

In recent years, resort to protectionism has led to the increasing adoption of non-tariff barriers to trade ("NTBs"), including OMAs, VERs, other quantitative limitations and export subsidies. The growing use of these types of measures raise several particular concerns for competition authorities, since their effects on the dynamics of markets differ from more traditional trade restraints, such as tariffs. Whereas a tariff only affects the price at which an importer can sell its products, quantitative restrictions place absolute limits on the amount of imports that can take place, and thus may exercise a more restrictive effect on competition. For example, in the case of an industry where there is a single domestic producer, foreign competition or the potential for imports prevents that producer from charging a monopoly price. Under a tariff-like policy, the domestic producer can raise its price, but only by the amount by which the tariff raises import prices. However, under a quantitative restriction, once the import limit is reached, the domestic producer can then raise prices even higher, unchecked by foreign competition.

Another effect involves the distributional consequences of trade restrictions. Under tariff-like policies or even quotas administered through licences sold by the country in the import market, the extra returns generated accrue to the government taking that measure. On the other hand, concerning NTBs that resemble cartels, e.g. VERs and OMAs, the extra returns often accrue to the government or firms of the exporting country.

In light of the potentially negative impact of restrictive trade measures on competition and thereby on consumer welfare, the report recommends that policy makers, when considering a prospective trade measure, undertake as systematic and comprehensive an evaluation as possible of the likely effects of the measure, including, *inter alia,* the impact on the structure of domestic competition and the long-term effects on the structural adaptation of the affected sector. To do this, the report sets out an indicative checklist of factors to aid policy makers and to improve decision-making, prior to adopting trade measures[4].

Laws on unfair trade practices

Laws against unfair trade practices and competition policy both share the common aim of removing artificial distortions in markets. But there are differences too in the interests they seek to protect and in the standards applied to regulate commercial conduct. As a result some actions brought under the unfair trade laws can reduce competition in domestic markets by raising entry barriers to foreign competitors.

The principal concern of competition policy is to protect *competition,* not *competitors:* it does not seek to protect inefficient competitors against lower prices achieved through efficiency, economies of scale, cheap labour or technological expertise, so long as the advantage is fairly attained. Nor, in most countries, does competition policy allow a departure from competitive principles for firms buffeted by recessionary conditions, shrinking markets or technological obsolescence.

Laws relating to unfair trade practices, on the other hand, aim at protecting domestic industry from import pressures causing injury to domestic competitors. Thus, the basic issue in the application of these laws is the legitimacy or illegitimacy of various competitive advantages enjoyed by foreign firms and the resultant harm to domestic industry. Under these laws, the effect of the practices on competition in the market and the ultimate effect on consumers are not at issue.

Accordingly, in the enforcement of anti-dumping and countervailing duty laws, different standards are applied to import pricing practices than if such practices were examined under competition laws and, in some cases, actions are brought under the trade laws against conduct that is permissible under the competition laws. The result of some of such actions may be reduced competition in domestic markets, particularly where high levels of concentration already exist, through the foreclosure of foreign firms.

The report suggests that care should be exercised to avoid a misuse of unfair trade proceedings by enterprises seeking to restrain foreign competition. It also recommends that a consensus should be developed on the extent to which policy-makers and enforcement authorities should give consideration to the impact on competition on domestic markets of actions taken under laws dealing with unfair trade practices.

Formulating and Implementing Policies

A final source of friction in trade relations at the national and international level arises from practical problems that occur in the formulation and implementation of competition and trade policies. In the past decade, disputes as to jurisdiction over business conduct have led to difficulties between trading partners. The growing internationalisation of business conduct has raised questions as to which laws govern a particular transaction. While all countries apply their competition laws to conduct that takes place within their territories, several countries also apply their laws to conduct occurring abroad which has a significant effect on their market. In addition to disputes between trading partners, differences as to the scope given to national competition laws can create uncertainty on the part of business planners.

Further, countries do not apply their competition laws to purely export activities of their domestic firms. Thus to promote exports, countries may encourage or allow their firms to engage in restrictive practices, even though such conduct may violate the competition laws in the import market. This too can prove disruptive to trade relations.

At the national level, increased co-operation between trade and competition officials could strengthen the resistance against protectionist measures. In most countries, arrangements of a formal or – more frequently – informal nature already exist to obtain the advice of competition authorities on trade policy measures, but they are not usually very effective in bringing to bear on trade policy any real influence based on the criteria of competition. OECD's report argues that this situation could be significantly improved if policy makers undertook the recommended analyses of the likely effects of prospective trade measures, with the assistance of competition authorities. In view of the diversity of government structures, OECD's report recommends no single institutional framework or rigid procedural arrangements for co-ordination between trade and competition policies, suggesting rather that informal but regular contacts, establishment of standing interdepartmental committees or formal public hearings could serve. It is recommended, too, that competition authorities be sensitive to the realities and developments in international trade and the growing internationalisation of markets.

4. *This check list is very similar to that recommended for assessing the effects of trade policy measures on the consumer; see* OECD Observer, No. 129, July 1984. *The present report provides some illustrative analyses of various types of restrictive trade measures in the framework of the checklist.*

A Positive Environment for Global Industrialisation

by Emile van Lennep,
OECD Secretary General[1]

The past three decades have witnessed a striking transformation of the international economy, reflecting changing patterns of industrial production and trade, and the emergence of important new participants. The heightened role played by many developing countries in this process is historically significant and carries important implications for the evolution of North-South relations. It also confounds earlier pessimism about the ability of developing countries to become full participants in global industrial activity. The augmented role of developing countries is a positive evolution – for themselves and for industrialised economies. Their greater participation has expanded investment and trade opportunities; it has created visible benefits for consumers; and, although less recognised, it has contributed positively to employment growth in their own and in developed countries. It in no way detracts from these positive features to acknowledge that increased industrialisation and trade in industrial products by developing countries makes all the more necessary the continuation of major adjustment efforts in the advanced economies.

The progress of industrialisation in developing countries has undoubtedly suffered a setback as a consequence of the recent international recession and the serious debt problem of a number of these countries. It would, however, be a grave mistake for these countries to respond to this setback by retreating into inward-looking policies and isolationism. Such a response would be to deny two very important lessons: first, the open multilateral system, as was demonstrated over recent decades, offers enormous opportunities for mutual gain by both established and new participants; second, those countries which have adopted outward-looking strategies have weathered the turbulent international situation much better than many whose resource-allocation policies have been more inward looking. In large measure this is because the requirements of successful international competition stimulate vigour and flexibility in economies and encourage a greater play of market forces.

The determination of developed and developing countries to regain some of the lost momentum of economic growth and international market opportunities should strengthen as recovery proceeds. Economic recovery has taken hold in the OECD area; along with this recovery, world trade has been expanding. In particular, imports into the OECD from the developing countries have been growing strongly over the past year. An important pre-condition for the current recovery of output and trade has been the moderation of inflation, and fortunately no significant re-acceleration is foreseen for prices in the OECD as a whole during the coming year.

In providing these moderately optimistic indicators of an improving economic situation, I do not want to pretend that there are no unsolved problems. High real interest rates and major financial imbalances represent a risk to international financial relations; inadequate flexibility in many of our economies may impede sustained recovery. Looking further ahead, while recovery is now a reality, we cannot yet be confident that the necessary conditions for sustained medium term economic expansion in the OECD area are in place. Growth over the next four or five years is likely to exceed the weak performance of the last ten years; but to do substantially better will require vigorous and sustained efforts to correct imbalances, improve the resilience of markets, and promote better allocation of resources. This policy challenge is one that is clearly perceived by OECD governments. It is imperative that this challenge be met if we are to make headway in bringing unemployment down in OECD countries. And it must also be met if we are to benefit fully from the changing patterns of global industrial activity.

Adjustment and Trade Policies: an OECD Perspective

The essential requirement of adjustment and trade policies is that they help promote the efficient operation of markets and meet demands for social equity. A clear consensus has emerged in OECD discussion that the best way to meet this requirement is through greater flexibility in the public and private sectors. Policies to improve the functioning of product, labour and capital markets, and to enable economies to adapt to innovation and change, are indispensable for improving economic performance.

OECD governments have recognised the importance for their own economies of the interrelationships between macro-economic performance, structural adjustment and international trade in adopting the concept of positive adjustment policies. A key orientation of such policies is to seek a better allocation of resources. This means promoting the movement of capital and labour into areas where they will be most productive. There is also a need to capitalise on the growth opportunities arising from new technologies, as well as to wind down activities that have become a drain on scarce resources, no longer contributing to prosperity. Such an orientation will help enhance economic efficiency in the medium term, strengthen investment – both quantitatively and qualitatively – and create viable new jobs.

In the trade policy field, OECD Member countries have recognised that protectionist measures not only distort economic relationships, but they also impede adjustment within the global economic and financial system. Moreover they add to rigidity and lack of vigour in the domestic economic structures of those countries that implement them. There is now a growing under-

1. *Statement at the UNIDO IV Conference in Vienna.*

standing that trade policies need to be considered as much in terms of the effective functioning of the domestic economy as in the more traditional sense of exchange of "concessions" among trading partners.

Within OECD, we are developing ways to put these observations to practical effect and reverse the drift towards protectionism. This is reflected in the decision of Member countries to take advantage of the economic recovery progressively to relax and dismantle trade restrictions and trade distorting domestic measures, in particular those introduced over the recent period of poor growth. A programme has been launched to develop specific proposals for individual and collective action, with a first report on such possibilities by mid-1985. Attention will be given to specific actions to expand imports from the developing countries.

Against this background of adjustment and trade perspectives, we need to consider carefully the role of government in the economies of both developed and developing countries. There is of course a range of traditions and preferences in this regard; but I believe that it is of central importance that government policies should create a climate which is conducive to enterprise and risk-taking and thus to industrial development. This means, among other things, creating a stable and predictable framework of policies in which private decision-makers can have confidence. Without this, investment and innovation are likely to fall short of aspirations.

Turning more specifically to the experience of developing countries, what is it that has enabled successive groups of these countries to upgrade their industrial activity towards more skill and capital-intensive production? The countries that have had sustained success in this area are precisely those that have emphasized the efficient functioning of their domestic economies, while at the same time participating fully in the global economy. Whatever the importance of the forces of external demand, conditions of supply also matter, and therefore domestic policies matter.

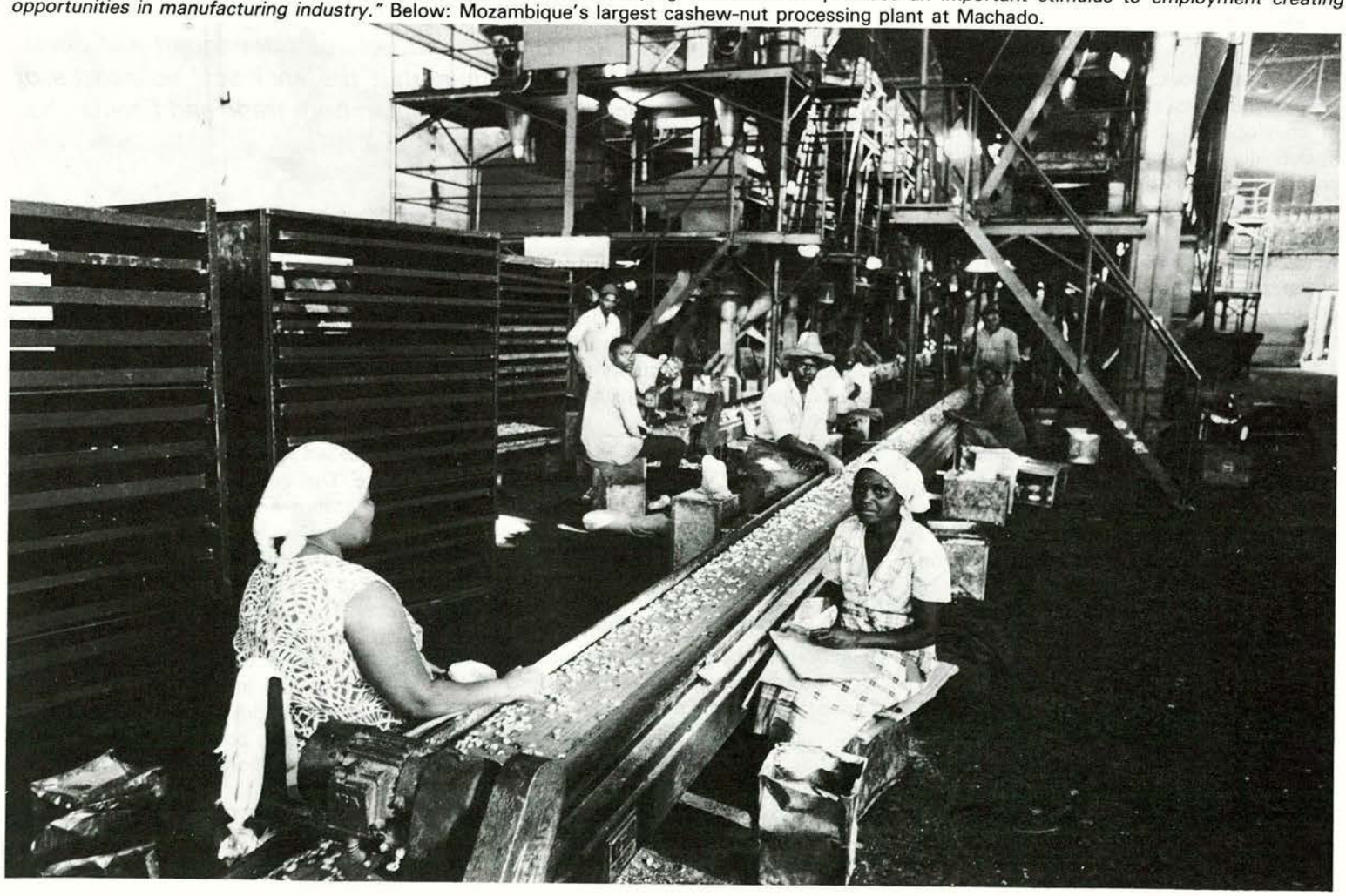
What this has meant in practice is that the successful countries have avoided distortions in factor prices, exchange rates and interest rates. For many of these countries this has also meant the development of mutually supportive links between industry and agriculture to achieve the most efficient deployment of scarce and expensive investment funds. The agricultural sector is crucial to the prosperity of most developing countries and provides an important stimulus to employment-creating opportunities in manufacturing industry.

I cannot pretend that the adjustments frequently called for in developing country economies are politically easy; they are certainly not easy for OECD countries. While the burdens associated with structural adaptation are visible and concentrated, the gains appear less certain and are often widely dispersed. This does not make the gains any less real or any less beneficial to economic welfare. Many of the least developed countries encounter especially difficult challenges in establishing the economic, institutional and physical basis for industrial development. OECD countries are fully committed to maintaining and strengthening cooperative efforts to help meet this challenge.

Industrialisation and International Co-operation

At the global level it is necessary to recognize the powerful links between development and industrialisation on the one hand, and economic policies, finance and trade on the other. The need is to foster, through international co-operation, an environment in which these linkages can play a dynamic role. It will be important

"The agricultural sector is crucial to the prosperity of most developing countries and provides an important stimulus to employment creating opportunities in manufacturing industry." Below: Mozambique's largest cashew-nut processing plant at Machado.



that developing countries play a full and active role in this process. One area which I believe offers particularly fruitful opportunities for co-operation is that of direct investment. Foreign direct investment has a key role to play in the steady development of efficient production and employment in developing countries and the integration of their industrial activities into global economic structures. We are working in OECD to help Member governments engage in constructive discussion with developing countries aimed at fostering an atmosphere of mutual confidence conducive to increasing investment flows.

Such an atmosphere should also foster other financial flows. Borrowing, and, for the poorest countries, aid will continue to be important sources of external finance. But conditions in recipient countries must be appropriate if commercial borrowing and development assistance are to contribute more to development. This will entail, first, allowing greater scope to private enterprise by reducing policy disincentives and administrative interventions; and, second, reducing governments' claims on resources by fostering the mobilisation and allocation of savings through local financial markets. But industrial countries have a role here, too: policy reform in developing countries can – in parallel – be encouraged and facilitated by the increased availability of adequate levels and forms of external finance.

Our recent work in OECD on how best to support industrial expansion in the context of development assistance has focussed specifically on small and medium sized enterprises – whether public or privately owned – in low-income countries. There are difficult problems here, but we have found that these difficulties have been easier to surmount in those low-income countries where greater emphasis has been put on efficiency and export orientation in their industries. There is a potentially large payoff if these efforts can be maintained.

It follows that an effective international agenda for discussion on global industrialisation must be accompanied by the identification and removal of obstacles to efficiency at the level of domestic economic management and an improved functioning of the international trade and financial system. The national and the international dimensions of the industrialisation process are inextricably linked. Concerted multilateral efforts, together with autonomous action based on enlightened self-interest, should be seen as twin elements in spreading the industrialisation process around the world in a way that advances development and human welfare in developing countries and is also of benefit to all.

The Dialogue Between Developed and Developing Countries: In Search of a New Consensus

by André Barsony[1]

In the last decade, the dialogue between developed and developing countries has been marked by a dichotomy – a shared desire to co-operate, on the one hand, and an all too frequent inability to arrive at mutually satisfactory solutions on the other. Is this because the solutions put forward have too often been based on outdated analytical premises? Has the dialogue between developed and developing countries been distorted by the absence of a conceptual consensus on the medium-term macro-economic dimension of their trade and financial relations? If one believes – as the author does – that it has, then the precondition for genuine co-operation between developed and developing countries would be to admit that the analytical consensus of the 1960s underlying this co-operation, in both trade and finance, has collapsed.

Breakdown of the Consensus

Two postulates were widely accepted by economists and politicians in the 1960s. The first is the *"engine of growth" concept* which holds that the international transmission of economic activity through trade is essentially a mechanical process of Keynesian-type multipliers: expansion of output in the developed countries leads to increased import demand and thereby to expansion in the exports and output of the developing countries. The second is the *"two-gaps" theory* which considers that growth of output in the developing countries is constricted by two bottlenecks: scarcity of savings, which limits the accumulation of productive resources, and scarcity of foreign exchange, which reduces the capacity to import and invest.

In this context, the role of international macro-economic co-operation was seen as supporting activity in the developed countries and promoting the transfer of real resources. Moreover, the existence of the Keynesian consensus in the developed countries at the time facilitated the search for international coherence: transfers of real resources could, if there was unemployment in the developed countries, stimulate final demand in the form of exports to the Third World.

The two prevailing conceptual approaches to macro-economic co-operation between the two groups of countries were both based on *assumptions of market failure.* The "engine of growth" theory, which assumes that developing countries' exports are determined mechanically by external demand, disregards the influence of shifts in relative prices and changes in supply. The "two-gaps" theory, likewise, is based on the assumption of a failure of the price system in the developing countries. Though a rise in interest rates and a devaluation should normally suffice to remove the two bottlenecks – scarcity of savings and of foreign exchange – many

1. *Head of Policy Concepts and Analysis Division, OECD Development Co-operation Directorate.*

economists considered that, in the developing economies, the rigidities were such that, for the market to generate such adjustments, changes in relative prices on an unacceptable scale would be necessary.

The events of the past decade have undermined the assumptions on which the old consensus was based: experience has shown that market-oriented policies can play a major role in realising the potential benefits of interdependence.

Competitiveness: A Proven Force

Contrary to the tenets of the "engine of growth" concept, exports of the developing to the developed countries are not determined mechanically by the general expansion of the latter's imports: they are heavily influenced by changes in relative prices and in supply which enable the developing countries to increase their market shares.

A recent OECD study suggests that the characteristics of supply have played a key role in the quantitative and qualitative evolution of developing countries' exports of manufactures to the OECD area. The study covers 25 countries, representing more than 90 per cent of OECD imports of these products from non-oil developing countries (excluding China). These exporters form three country groups: non-OECD Newly Industrialising Countries (NICs), new dynamic exporters of manufactures (the "second wave"), and established less dynamic exporters of manufactures[2]. According to the constant market shares technique, changes in a developing country's exports of manufactures to the OECD area can be explained by the following four factors: the general increase in OECD imports (the "engine of growth" concept), the change in the geographical destination of exports, changes in product composition, the remainder being attributed to greater competitiveness[3].

It will be seen from Table 1 that, for the three groups of countries, the general expansion of OECD imports serves to explain only part of the growth in exports of manufactures. In the case of the first two groups of countries, a comparison of columns (6) and (2) shows that improved competitiveness accounts for more than 50 per cent of the absolute increase in exports of manufactures for most of the periods. The results are different for the third group: improved competitiveness contributed less to the absolute increase in exports while the change in geographical destination and product composition have often had a negative effect on exports.

Such differing performance underscores the importance of supply characteristics in developing countries' capacity to export.

1. OECD IMPORTS FROM 25 DEVELOPING COUNTRIES: A CONSTANT MARKET SHARES ANALYSIS

US $ Million

		OECD imports from group (1)	Absolute change in export value (2)	Part of increase in exports due to: Increase in OECD imports (3)	Destination of trade (4)	Product composition (5)	"Competitiveness" (6)
Non OECD newly industrialising countries (NICs)[1]	1969-71	4,215	2,792	1,249	23	84	1,436
	1974-76	17,634	13,419	6,395	−371	630	6,765
	1979-81	47,299	29,665	18,909	438	1,580	8,739
New dynamic exporters of manufactures[2]	1969-71	341	170	150	1	−8	27
	1974-76	1,973	1,632	517	−16	34	1,097
	1979-81	7,483	5,510	2,115	42	107	3,246
Established less dynamic exporters of manufactures[3]	1969-71	1,257	384	766	−35	−257	−90
	1974-76	3,106	1,849	1,907	−163	−171	276
	1979-81	7,634	4,528	3,330	26	1	1,171

1. Brazil, Hong Kong, Korea, Mexico, Singapore, Taiwan, Yugoslavia.
2. Haiti, Indonesia, Macao, Malta, Malaysia, Mauritius, Morocco, Peru, Philippines, Sri Lanka, Thailand, Tunisia.
3. Argentina, Colombia, India, Israel, Pakistan, Uruguay.

While trade policy and the level of economic activity in the developed countries play a role, developing countries' policies – trade and exchange rate policies, and incentives affecting domestic product and factor markets – have a considerable influence on export possibilities.

Investment Efficiency: A Neglected Factor

According to the "two-gaps" theory, measures to promote savings in the developing countries are ineffective since incomes are close to subsistence level. As can be seen from Table 2, experience suggests otherwise: until recently, *domestic savings ratios* in all categories of developing countries, apart from the least developed countries, rose considerably.

Table 2 also highlights the changes over the 1970s in the *overall savings/investment balances.* These have eased the second constraint of the two-gaps theory – the scarcity of foreign exchange. The ratio of investment to GDP in the developed countries has fallen, and the savings ratio still more, so their exportable savings have become nil or even negative. In the oil-importing developing countries, on the other hand, investment ratios have risen significantly as have their savings ratios – though less so – such that investment has had to be financed by an increase in capital imports. In fact, the share of the latter in GDP has almost doubled. Although in the oil-exporting countries investment ratios have risen steeply, savings ratios have climbed still higher; their net savings became, in the 1970s, the most important source of real resource transfers.

In the circumstances, it seems doubtful whether scarcity of savings and foreign exchange can be considered as the main reason for the economic growth problems some of these countries have encountered. More likely, it is the degree of efficiency of investment in developing countries that explains in large measure the marked differences in their rates of economic growth. Contrary to the the two gaps theory, performance in the past decade suggests that domestic economic policies affecting the characteristics of the demand for capital (return on and security of investments) and the domestic savings supply are as important as international efforts to generate a larger supply of external finance. →

2. The product coverage in this study is based on OECD imports of manufactured goods according to SITC (Rev. 2) code 5-8 less division 68.
3. The total market share actually obtained by the countries minus the share they would have obtained if the product and geographical composition had not changed.

2. CAPITAL FORMATION, DOMESTIC SAVINGS AND INTERNATIONAL CAPITAL TRANSFERS 1960-81

	Gross Capital Formation % of GDP				*Domestic Savings % of GDP (annual averages)*				*Capital Imports (–)* Capital Exports (+)* % of GDP*				*Capital Imports (–)* Capital Exports (+)* Current US$ billion (annual averages)*			
	1960 1966	*1967 1973*	*1974 1978*	*1979 1981*	*1960 1966*	*1967 1973*	*1974 1978*	*1979 1981*	*1960 1966*	*1967 1973*	*1974 1978*	*1979 1981*	*1960 1966*	*1967 1973*	*1974 1978*	*1979 1981*
Total World Market Economies	**21.5**	**22.8**	**22.9**	**22.9**	**21.7**	**23.2**	**23.1**	**22.7**	**0.2**	**0.4**	**0.2**	**–0.2**	**3**	**10**	**11**	**–16**
Developed Market Economies	**22.1**	**23.3**	**22.7**	**22.5**	**22.7**	**23.9**	**22.8**	**22.3**	**0.7**	**0.8**	**0.2**	**–0.1**	**9**	**17**	**12**	**–5**
Major Industrial Economies	21.5	22.8	22.3	22.4	22.4	23.7	22.9	22.5	1.0	1.0	0.7	0.3	11	20	27	21
Other Industrial Economies	26.5	26.2	23.8	22.5	26.0	27.0	23.8	22.1	–0.4	1.0	0.0	–0.3	–	2	–	–2
Other Developed Economies	25.2	25.5	24.9	23.9	22.6	23.0	20.5	19.9	–2.8	–2.8	–4.7	–4.4	–2	–4	–15	–23
Developing Market Economies	**18.3**	**20.3**	**24.0**	**24.4**	**16.3**	**18.9**	**24.2**	**24.1**	**–2.4**	**–1.8**	**0.0**	**–0.6**	**–5**	**–7**	**–**	**–11**
Oil Exporting LDCs	18.7	21.3	25.8	26.3	19.3	22.3	32.6	32.9	–0.3	0.0	6.3	6.3	–	–	26	66
Oil Importing LDCs	18.2	19.9	22.8	23.0	15.3	17.5	18.9	17.9	–3.2	–2.6	–4.1	–5.4	–5	–7	–26	–60
High Income	20.7	21.8	23.9	24.0	18.4	19.8	20.2	19.7	–2.6	–2.2	–4.0	–4.8	–2	–4	–17	–38
Middle Income	16.7	19.3	24.6	25.4	12.9	15.8	16.3	17.6	–4.0	–3.8	–6.3	–8.3	–2	–3	–11	–25
Low Income	16.1	16.6	19.3	21.3	12.9	14.4	16.0	16.7	–3.4	–2.3	–3.3	–4.4	–2	–2	–5	–12
of which LLDCs	*11.2*	*11.9*	*13.6*	*15.7*	*9.2*	*8.5*	*5.7*	*6.6*	*–2.0*	*–3.3*	*–7.9*	*–9.0*	–	*–1*	*–3*	*–6*

** Gross domestic savings less gross capital formation.*

Source: Based on information supplied by the UN Office of Development Research and Policy Analysis.

The Structure of Capital Flows and the Debt Burden

In the 1970s there was a considerable shift in the relative importance of the various channels through which financial resources are transferred to the oil-importing developing countries (Table 3). At the begining of the 1980s, the share of total official flows was only slightly less than it was ten years earlier, though the share of non-concessional assistance – including export credits and credit guarantees and multilateral non-concessional lending – expanded relative to concessional flows.

In the category of purely private flows, the share of bank credits over the same period increased considerably while the share of direct foreign investment fell. As a result, while the share of private commercial resource transfers did not increase very much, the "non-debt-creating flow" (direct investment) was in part replaced by a "debt-creating flow" (bank credits).

Thus, overall, as regards financing both by the private and public sectors, the greatest increase has been in flows with the highest cost to the borrower. Logically, this results in a higher *debt-carrying burden* for a given transfer of resources. This shift in the structure of capital flows reflects, of course, changes not only in capital supply but also in capital demand, and, in particular, the tendency of developing countries in the 1970s to substitute bank credits for direct foreign investment and, in many cases, to finance increasing public sector deficits through foreign rather than local borrowing.

In sum, the experience of the past two decades with international trade and international real resource transfers has shown that the price system plays a major role both in the developing and in the developed countries. In the *short run,* prices are flexible and adjust quite rapidly to sharp changes in supply and demand and, in the

3. COMPONENTS IN THE INCREASE OF FINANCIAL RESOURCE FLOWS 1970 AND 1982

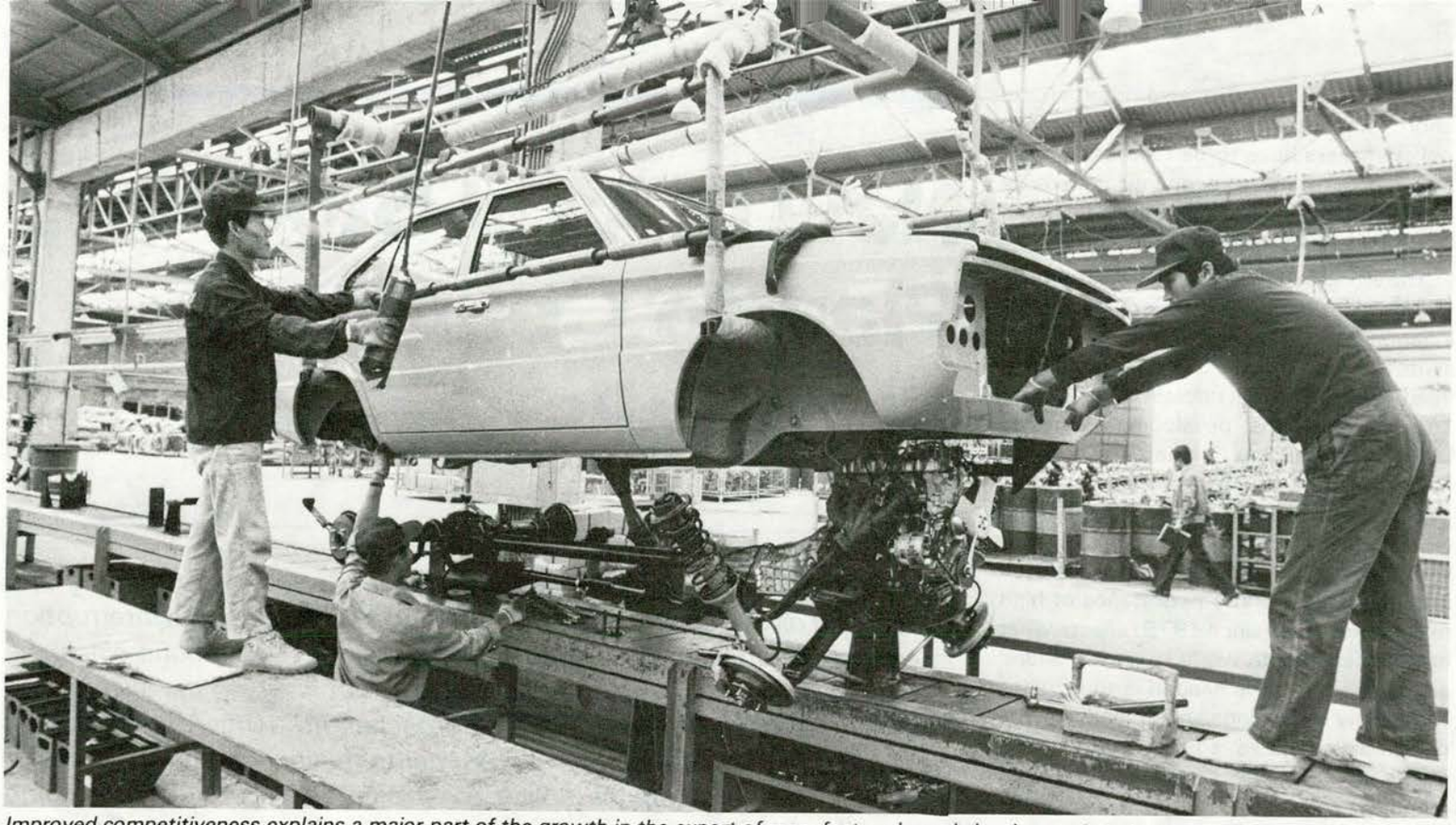
Grants, direct investment and other official and private financial flows with maturities of more than one year

real terms: 1981 prices and exchange rates

	1970		*1982*	
	$ billion	*% of total*	*$ billion*	*% of total*
I. Official Development Assistance (ODA)	21	41	35	36
II. Private grants	2	4	2	2
III. Non-concessional	28	55	61	62
a) *Private commercial*				
Direct investment*	10	20	14	14
Capital market finance (bank sector + bonds)	8	16	23	23
b) *Official or officially-supported*				
Exports credits (DAC countries)	7	14	12	12
Other	1	2	5	5
c) *Multilateral*	2	4	7	7
Total	**51**	**100**	**98**	**100**
Memo Items:				
Official sector + private grants [I + II + III(b) + III(c)]	*33*	*64*	*61*	*62*
Private commercial sector III(a)	*18*	*36*	*37*	*38*

** For direct investment, the 1982 figure is in fact an average of 1981 and 1982. Direct investment flows have fluctuated considerably in the last few years and the 1981-82 average seems a reasonable representation of the trend level in the recent period.*

Source: Development Co-operation, Report by the Chairman of the Development Assistance Committee, *OECD 1983.*



Improved competitiveness explains a major part of the growth in the export of manufactured goods by the newly industrialising countries. Above: the Hyundon car plant in South Korea. Below: hosiery manufacture at Araquara in the state of Sao Paulo, Brazil.

medium run, supply and demand are fairly elastic. In these conditions, the remedies based on assumptions of market failure that came out of the consensus of the 1950s and 1960s no longer provide a basis for dialogue. The lessons taught by the 1970s are clearly drawn: market-oriented policies can play an essential role in realising the potential benefits to be derived from the integration of the developing countries into the international system of trade and finance.

The International Coherence of National Policies

To say that the economic growth of the developing countries would quicken if policies in those countries were geared more to the market is in no way to detract from the importance of international co-operation. It would be a mistake to think that national policies *alone* can restore the conditions for lasting, non-inflationary growth. The international context in which these national

policies operate must also improve. In short, it means that the efforts of economic policy-makers have to be focussed on the medium-term, macro-economic coherence of trading and financial relations between developed and developing countries.

The world macro-economic environment featuring, from the 1970s on, persistent inflation and low real interest rates, switched, as from 1979, to moderate inflation and high real interest rates. During both periods, the developing countries received misleading "signals" about the cost of capital from the international financial markets: first it was too low, which induced them to borrow too much, then it was too high, which prevented them from investing enough. The persistence of high real interest rates since 1979 reflects what has happened with world savings demand and supply. What is needed is to increase the supply of savings, particularly in the developed countries, so that world investments and savings can balance out at moderate real rates of interest.

In the field of international trade, a halt has to be called to the restrictive trends currently characterising the policies of both developed and developing countries. In the developed countries, this should mean a progressive dismantling of the tariff and non-tariff measures that are hampering structural adjustment, a redefinition of safeguard clauses so that restrictive measures are subject to rules of multilateral discipline and surveillance, and a more limited use of subsidies. In the developing countries, the object must be to ensure that trade and exchange rate policies, as well as the incentives applied to domestic product and factor markets, help to improve resource allocation and external viability and not to protect sectors where costs are high or simply reduce import bills.

In conclusion, therefore, it is important to recognise that the old consensus based on assumptions of market failure has permanently collapsed under the weight of events. It is by increasing their awareness of the need for coherence in the medium-term, macro-economic dimension of their trade and financial relations that developed and developing countries will be able to base international co-operation on a new analytical consensus. How world-wide this coherence would need to be could be discussed at length. What is important is that, in a world where the sound functioning of the global economy depends increasingly upon how the more advanced developing countries can be integrated into the international trading and financial system, a new consensus should come into being to sustain action in developed and developing countries alike.

New IEA Oil Stocks Plan to Counter Shortfalls

The International Energy Agency's emergency system for sharing and conserving oil in a supply crisis may be triggered if there is an interruption in expected supplies of seven per cent or more. Disruptions since the 1973-74 oil shock caused shortfalls below that level, so the system has never been used. But as the IEA approaches its 10th Anniversary on November 18, the member governments have agreed on a major extension of the Agency's ability to shield them from the damaging economic consequences of a supply disruption. The IEA's new Executive Director, Helga Steeg, explains the new instrument, and the reasons for its creation.

Looking back, one can only be amazed at the extent of the economic damage caused by the oil supply disruption of 1979, the year of the Iranian Revolution. After all, the 160 per cent increase in oil prices over that year and 1980, when the Iran-Iraq war broke out, resulted from a net supply loss of about 2.5 million barrels a day, or one-twentieth of total oil demand in the world outside the centrally planned economies, for only three months. But nobody knew at the time what lay ahead. Hence the price explosion on a world market which then was broadly in balance, in contrast to today's oil market, where supply is well in excess of demand.

The disruption at the end of the 1970s came at a particularly bad time for the OECD countries, hitting before their economies had fully recovered from the first oil shock of 1973-74. The price rise was imposed on an already high level of oil prices, and perhaps this helps to explain why the economic repercussions were out of all proportion to the size and duration of the shortfall. The 1979-80 oil shock contributed to a fall in the OECD economic growth rate from 3.4 per cent in 1979 to minus 0.5 per cent in 1982. Inflation increased from eight per cent in 1979 to 12 per cent in 1980. Unemployment in the OECD rose from 18.9 million in 1979 to 24.7 million in 1981. OECD economists have calculated that the oil price increases cost each man, woman and child in the OECD countries $1,300.

COMPANY AND GOVERNMENT-OWNED STOCKS IN THE OECD AREA ON 1st JULY

	Company		*Government*		*Total*	
	Mill. of Metric Tonnes	*Days of Forward Consumption*	*Mill. of Metric Tonnes*	*Days of Forward Consumption*	*Mill. of Metric Tonnes*	*Days of Forward Consumption*
1978	396	78	6	1	402	79
1979	385	76	22	4	406	80
1980	457	97	21	5	478	102
1981	440	99	36	8	476	107
1982	392	94	52	13	444	107
1983	355	85	63	15	418	100
1984	340	79	77	18	417	97

Note: Figures may not add due to rounding.

Markets reacted in an exaggerated way to the events of 1979 which quickly became known as "the second oil shock". It was largely fear, uncertainty, and speculation that produced the massive price increase experienced over that period, not the fundamental realities of the supply-demand balance. All the IEA governments agree that such a situation must not happen again, and that they should be prepared to exercise a calming influence, if need be, to help markets remain steady in any future disruption.

Against this background, the Governing Board of the IEA agreed at its meeting in Paris on July 11 that oil stocks, and particularly those owned or controlled by governments, should be used early on in a significant supply disruption if this is judged necessary in order to prevent panic buying. The agreement complements but does not alter the IEA's existing emergency system and its trigger of a seven per cent loss in supplies. The arrangements under the emergency system, including oil sharing, demand restraint, and the holding of emergency stocks, remain in full force. The new arrangement therefore represents a major extension of the IEA's ability to shield its members from the adverse consequences of any interruption in their supplies of oil.

It would, of course, be for the Governing Board of the IEA, representing all the member governments, to determine what action should be taken to meet a supply disruption under existing IEA agreements. But as a result of the July 11 decision, those countries that have significant stocks available will consult together on whether to use them, and on timing, amounts and methods. In this way, they will be able to put stocks on the market quickly, in order to prevent the type of excessive market reaction experienced in 1979. These stock consultations would be open to all OECD countries, and would form an integral part of the industrialised countries' overall response to a supply shortfall.

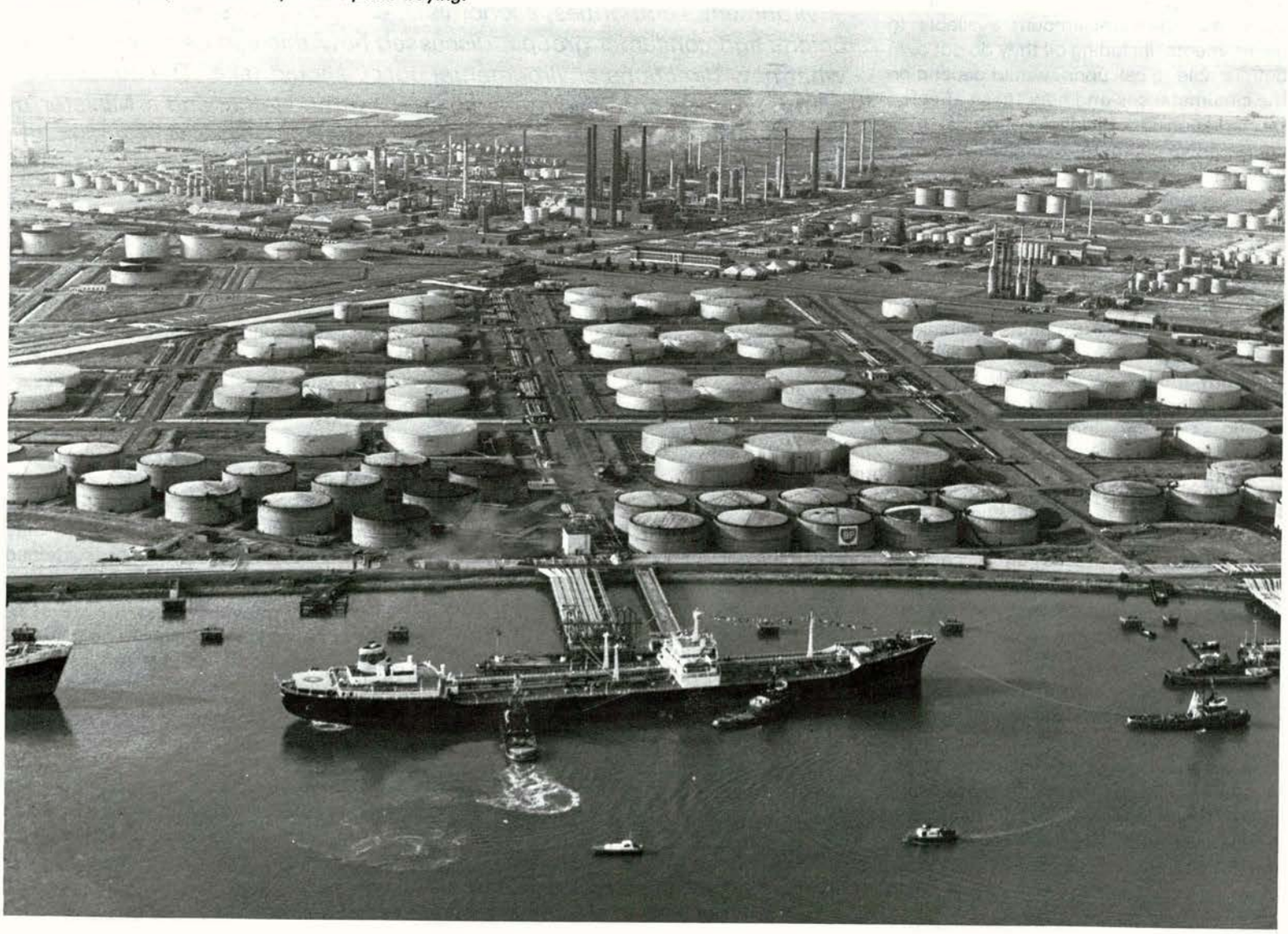
The mechanics of the arrangement are flexible. They are designed to involve all IEA governments in countering excessive price movements, and not just those that are able to deploy significant amounts of stocks. Countries will be able to use stocks, demand restraint, and fuel switching, or a combination of these. It will obviously be important to ensure that none of the IEA countries acts in a way that may detract from the effect of releasing stocks on to the market. This explains the emphasis on co-ordination.

Quite deliberately, the Governing Board refrained from setting trigger points, or defining precise circumstances which would justify a co-ordinated drawdown of stocks. This permits the IEA to base its actions entirely on the situation at the time of the shortfall, and the nature of the shortfall itself. The objective is timely and effective action, given that any hesitation or delay in some highly volatile supply emergency could negate our efforts.

Why Now? Why Not Earlier?

Two questions have been raised about this new IEA instrument, and both of them concern timing. The first is "Why now?". After all, so the argument runs, the world is awash with oil. Another scramble to buy, regardless of dizzily spiralling prices, seems unlikely, at least in the forseeable future. The answer, of course, is that today's

Government owned stocks have more than quadrupled since 1979 (in terms of days of forward consumption). Under the new IEA plan they can be put on the market quickly in order to prevent panic buying.



impossibility can quickly become tomorrow's probability, and the day after's accomplished fact. Better to be prepared, well before any crisis breaks!

The second question is "Why not earlier?", meaning before the Iranian Revolution, or at least immediately after it. That question is usually accompanied by a reference to closing the stable door after the horse has bolted. The answer is that in 1979 and 1980 the industrialised countries lacked the means to calm the market, because their governments did not own or control enough stocks. That has changed (see table). In 1979, company stocks in the OECD amounted to 76 days of forward consumption, while the governments could muster only four days. Since then, and at the time of writing, the government component has built up steadily to 18 days of forward consumption out of a total of 97 days for company and government stocks combined.

The biggest government stockpile of all is the United States' Strategic Petroleum Reserve, which now stands at over 400 million barrels, well on the way to its target of 750 million barrels. Other countries possessing sizeable government stocks include Japan, the Federal Republic of Germany, and some other European countries. The total amount available to governments, including oil they do not own but are able to call upon, would depend on the circumstances and how these affected the situation in individual countries. At a conservative estimate, the figure would be well in excess of 100 million tonnes. Stocks owned outright by governments amount to 77 million tonnes.

The very existence of the IEA stocks agreement should be a stabilising influence in times of market stress, but it is not a cure-all, and other instruments available to the IEA retain their importance. Weathering any future supply crisis will demand sound judgment, and a combination of responses on the lines described in this article.

The IEA will continue its examination of stock policy. Issues to be studied include the determination of minimum operating requirements for stocks on a country-by-country basis, practical problems that may arise in carrying out a stockdraw, the role of demand restraint, and fuel-switching.

The IEA Governing Board took care to make its dispositions at a time when a supply crisis seemed a remote eventuality. Because they were not reacting to the pressure of events, the 21 IEA governments made it easier for themselves to devise a consensus that will last. If you like, the IEA governments accepted the wisdom of taking out insurance when you can afford it, and before trouble strikes.

Economics and the Environment: Not Conflict but Symbiosis

Opinion polls in the United States, Japan and the European Communities prove that there is a widespread, sustained public demand for environmental protection, and disprove the superficial impression that governments are only under pressure from "Greens" and other minority groups. Faced by this demand, by new environmental problems and by a backlog of "conventional pollutants", governments must take advantage of the economic recovery to push environmental policies forward, despite budgetary constraints. A recent OECD Conference on Environment and Economics attended by Ministers of the Environment and other environmental authorities, economists, energy experts, employers, trade unions and consumer groups, discussed how this can best be done and what new directions environmental policy should take. The conclusions of the conference, which was chaired by the Netherland's Minister of Housing, Physical Planning and the Environment, Pieter Winsemius, are presented below.

Although unemployment remains unacceptably high, overall economic conditions are improving – with growth, on average, foreseen at a rate above four per cent in the OECD area this year with wide variations around this average. This growth, if sustained and extended, will inevitably have both positive and negative implications for the environment.

Emerging Trends

The conference recognised that renewed economic growth, whilst bringing benefits, leads to higher levels of conventional pollutants, thus imposing greater pressures on environmental resources, with higher damage costs, unless environmentally favourable measures are taken. Renewed growth will also accelerate the emergence of new and complex pollution problems, linked to new technological developments. A number of delegations stressed the need to reduce emissions below current levels.

The conference further recognised that the traditional scope of environmental policy is expanding to embrace quality of life issues (especially urban amenities) and critical issues in natural resource management which are increasingly important for sustained economic development, but where the lack of adequate scientific and other data and the long time scales involved pose special difficulties. In certain cases, present policies, sometimes reflecting inadequate valuation of resources, are leading to actions (e.g. in relation to water, soil and forests) that are not only environmentally unacceptable, but may also undermine the basis for sustained economic development.

Industrial innovation and the development of new technologies carry significant implications, both positive and negative, for environment and resource issues by inducing changes in the structure of economic activity, and in patterns of consumption, investment, employment and trade. Appropriate structural adjustments, which respond to environmental requirements as well as to market forces and technological developments, should be promoted, especially at the beginning of the business cycle.

The growing regional and global dimension of many of these issues and their potential economic and financial consequences, whether action is deferred or action is taken, call for the urgent and continuing examination of them on an international basis, as well as for increased action at the national and local levels.

Environmental Management and Economic Growth

Continued environmental improvement and sustained economic growth are essential, compatible and interrelated policy objectives for OECD Member countries. This, the major conclusion of the conference, means that the environment and the economy, if properly managed, are mutually reinforcing, and are supportive of and supported by technological innovation.

The conference noted that, in most OECD countries, public demand for better environmental quality remained high during the recession. Renewed economic growth is likely to increase this demand and to broaden it, and at the same time, to make it politically and financially more possible for governments to respond to it.

The resources of the environment, which are the basis of economic and social development, are scarce. Inadequate environmental policies may have adverse consequences in all fields. Improved management of environmental resources is therefore necessary. Strengthened international cooperation, both within and beyond OECD, is essential to develop the appropriate tools and to put them into use.

The conference recognised that environmental policies must be justified on their own merits for environmental reasons. However, on the basis of the substantial evidence available to it, the conference concluded that the benefits generated by environmental measures (including the damage costs avoided) have generally been greater than their costs.

The macro-economic effects of environmental policies on growth, inflation, productivity and trade have been minor, whilst some positive effects on employment and technological innovation have been demonstrated. At the level of individual firms, industrial sectors or communities cost impacts can be substantial and can lead to environmentally desirable structural, process or product changes. The impacts of these changes can fall unequally on different groups and regions and environmental policies should consider equity aspects.

Towards More Effective and Efficient Environmental Policies

The conference concluded that OECD Member countries are at a watershed in the evolution of environmental policies. New directions are needed in order to achieve a continuous improvement in environmental conditions and to avoid irreversible damage to the environment.

Three such directions were identified as fundamental at both national and international levels:

"Environmental issues are no longer limited to environmental pollution. They have changed in scope and scale to embrace the utilisation and management of natural resources and urban issues, especially amenities and the quality of life. While most of these issues have localised sources, their effects are increasingly regional and global in scale. The economic and social implications of many of these new issues – the threat of contamination and depletion of underground water, erosion, desertification, acid rain, the loss of soil fertility and climatic change induced by rising levels of carbon dioxide in the atmosphere – are greater than ever before. At the same time the battle against more conventional pollutants that was already on the agenda is far from won."

Pieter Winsemius, Minister of Housing, Physical Planning and the Environment, the Netherlands.

An illuminated indicator gives the state of air pollution in Tokyo.

1. Integration of environment and economic policies.

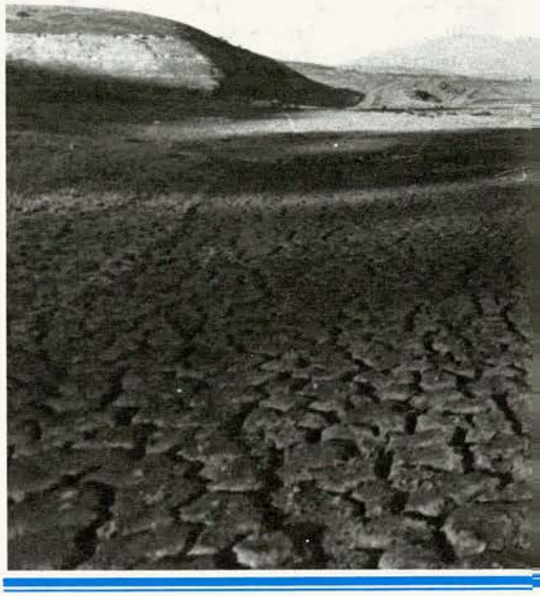
Development trends in all OECD Member countries offer significant opportunities for long-term economic gains through sound management of the environment, as well as risks of major losses. If these gains are to be realised and the losses minimised, including those of a social character, the conference concluded that environmental considerations should, as a matter of priority, be brought effectively into the centre of national decision-making on overall economic policy. They also need to be fully integrated with other policies such as agriculture, industry, energy, transportation and land use management.

The means to achieve this integration are available and include:

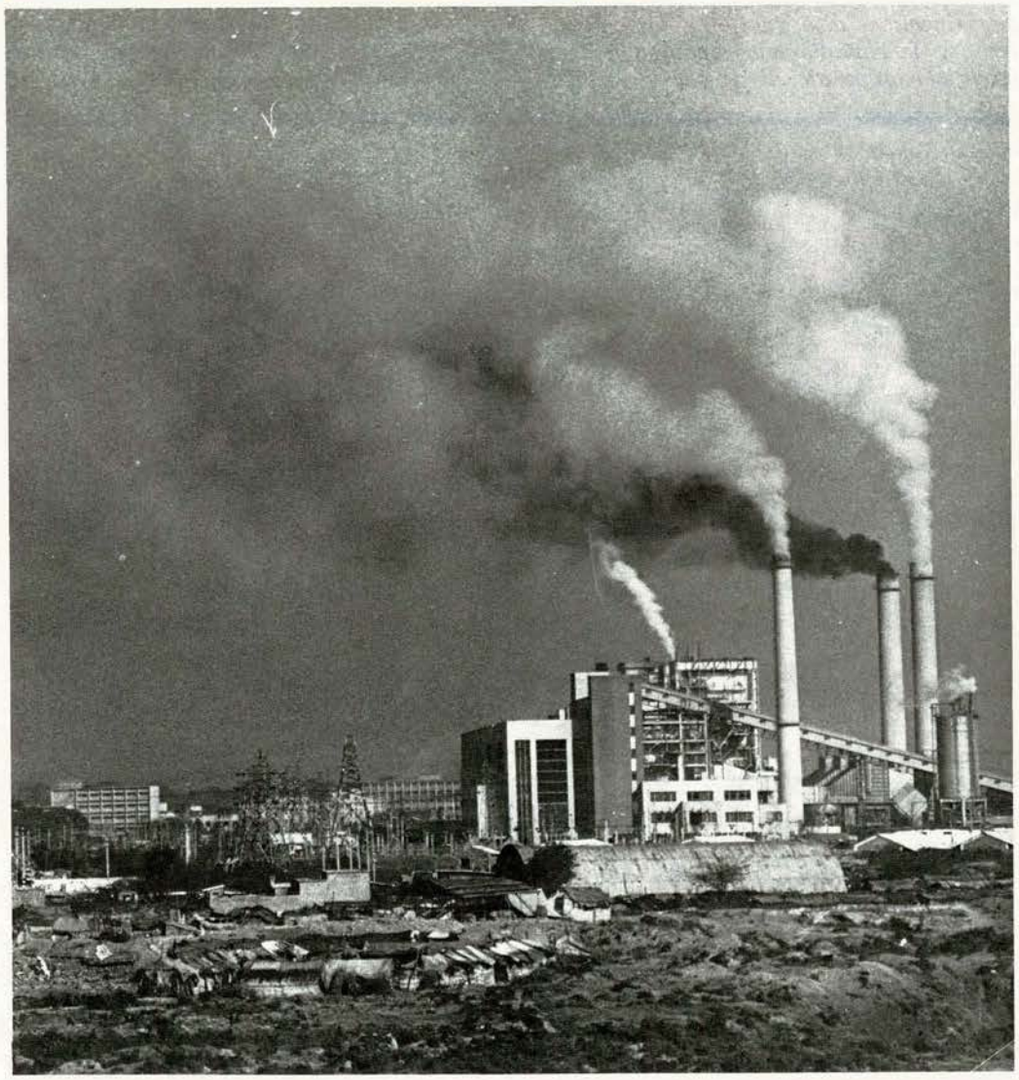
- *Improving institutional arrangements:* with planning, programme review and budget procedures that ensure continuing interaction between the environmental authorities and other government departments, especially at early stages of policy development;
- *Improving aids to decision-making:* amongst them, environmental impact assessment, cost-benefit analysis (in both physical and monetary terms) and risk assessment;
- *Extending effective forms of environmental impact assessment to proposed policies,* as well as programmes and projects, that have potentially significant implications for environmental and resource management;
- *Including environmental considerations in planning:* especially land use planning, zoning and development control schemes;
- *Increasing public information and involvement:* by making available to the public relevant facts about risks, benefits and costs, thereby ensuring that it is in a position to express its preferences;
- *Adopting a multi-media approach to management,* in order to treat pollution problems that occur in different environmental media – air, water or land – in an integrated manner.

"The pollution problem is moving south. The growth in the industrial-related environmental problems of the developing countries has at least parallelled the growth in their industrial capacity. Far from being peripheral to the interests of developing countries, environmental issues must now be seen as absolutely central to their development prospects. The principal environmental battles in the period ahead will undoubtedly be fought in the developing countries, and the future security of the global environment will depend on the outcome of these battles."

Maurice F. Strong, Canada, former Executive Director, United Nations Environmental Programme.



"Quarrels over the conflict either real or supposed, between protection of the environment and sound management of natural resources, on the one hand, and economic development on the other, are being replaced by a growing appreciation of the ways in which

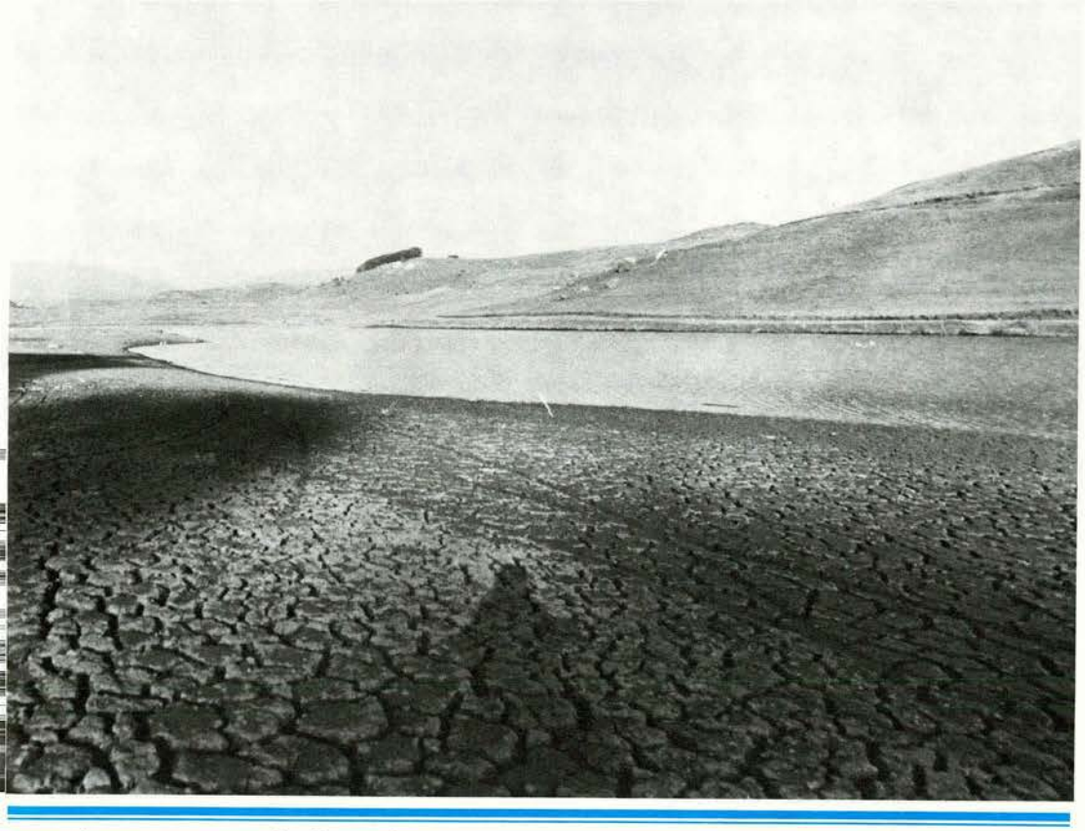


2. A stronger basis for "anticipate-and-prevent" strategies

Although "react-and-cure" strategies remain necessary to deal with existing problems, "anticipate-and-prevent" strategies which are attractive from the point of view of economic efficiency and cost-effectiveness, will increasingly be needed. By their nature they are difficult to apply because they often call for action in advance of demonstrated damage, scientific certainty and public support and require a strong data and knowledge base.

The conference concluded that strengthening this knowledge base was necessary, urgent and cost-effective and that the means were available to do it, including:

- *Economic evaluation* of the potential advantages of anticipatory action
- *Improving inter-disciplinary scientific research* on priority environmental issues
- *Improving the collection of data* on environmental quality, resources, benefits and expenditures at national, regional and local levels

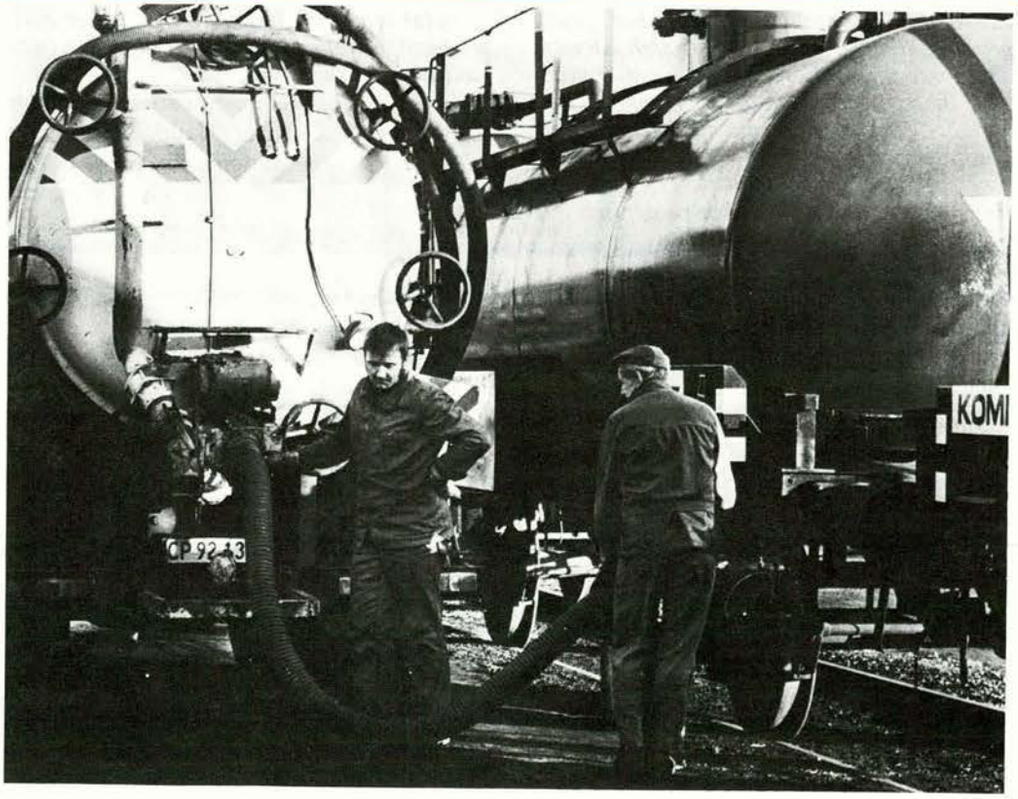


the two support each other. Fifteen years ago, many believed that environmental protection could be bought only at the expense of slower economic growth. Today, we know that at the macro level that is not true. Beyond that, we also know from our work on urban decline, development assistance, and other fields, that economic development is often not sustainable in a dirty environment or on a badly degraded resource base."

Emile van Lennep, OECD Secretary-General.

"The West's industrial nations should adopt a common basis for assessing environmental risks through cost-benefit analysis and use this to derive joint priorities for controlling them. A unified approach would be invaluable in dealing with such problems as the risks connected with substances in international commerce and with the natural transport of pollutants across international borders."

William D. Ruckleshaus, Administrator, Environmental Protection Agency, The United States.



- *Improving public understanding* of environmental objectives and policies through environmental education and training.

3. More cost-effective and efficient environmental policies

The conference noted the substantial evidence demonstrating that the effectiveness and efficiency of environmental measures can be improved by various means, and concluded that the following were of special importance:

- *The consistent application and extension of the Polluter-Pays-Principle,* which aims at ensuring that polluters bear the costs of pollution control and consequently that they are not subsidized or given unfair trade advantages over their competitors;
- *More effective use of economic instruments,* with their reliance on market type mechanisms, as complements to regulatory instruments;
- *Streamlining and improving institutional and regulatory systems* with a view to improving coherence in policy, consistency in regulation and decision-making processes, to ensure adequate enforcement and to avoid negative side effects.
- *Encouraging consultation between regulatory authorities and industry* in order to increase the understanding of environmental policy requirements and of problems in their application; and to provide appropriate time schedules for compliance;
- *Encouraging employee participation* in environmental protection measures undertaken by firms (including those affecting working conditions), through the provision of adequate information.

Strengthening International Co-operation

The growing interdependence of the world's economic system has become a central question for governments as they examine the critical issues likely to dominate the world scene to and beyond the turn of the century. This interdependence is seen to cover not only population, energy, food and technology, but also the environment, which constitutes the resource and ecological base for sustainable future development. The conference recognised the need for increased international co-operation in relation to key problems of a global or regional character or where direct impacts on neighbouring countries arise. Furthermore, at a national level, environmental policies should reflect the reality of global environmental interdependence. The conference noted that in many cases, these problems stem from the activities and policies of the advanced industrial societies; but that rapid industrial and population growth in developing countries will

"To us the environment is the support system for all human activities, and therefore we don't need to apologise for wanting to protect it. And therefore, the status of the environment, I submit to you, is not secondary to economic goals, and therefore the environment can no longer be considered, as it used to be perhaps in the past, as an amenity in life; the environment is our life support system."

Charles Caccia, Minister of Environment, Canada.

"One way to look at environmental damage is that of absolute purism, of conservation at any cost. No more land to be built on; no more hedges to be uprooted; no more power stations to be constructed; no emission of sulphur oxides or particulate smoke. But any economist, and I hope most Ministers, would rebel at such an absolute approach on any topic. For the most part, we must be prepared to trade off environmental benefits against other goods, provided that we strike a very tough bargain. The speed at which we approach better practice, the cost per year of improvement is a variable, open to political choice. It is not an absolute, and not every technical advance in anti-pollutant control is worthy of purchase. But some absolutes should be recognised. We should require resistance to irreversible changes in the environment, the destruction of natural or human ecologies that are irreplaceable. In practice, pollution, or rather the state of absolute purity which we might call "non-pollution", is a moving target. Legislation, and popular understanding of the issues, and popular sentiment in favour of a better environment, are effectively tightening our grip on polluters all the time."

Michael Posner, Economic Director, National Economic Development Office, United Kingdom

also be increasingly important. The special responsibility of OECD Member countries to co-operate in seeking solutions, especially with developing countries and relevant international organisations, must be acknowledged.

The conference concluded that several forms of co-operation on environmental and resource issues have proved effective and could be extended and deepened through the use of the OECD's capabilities in providing a forum for the early recognition, analysis and resolution of these issues. These include:

- Encouraging the development of an improved capacity on the part of Member governments to undertake co-ordinated and integrated policy analysis, including the development of appropriate methodologies and of long-term scenarios at global, regional and national levels;
- Preparing periodic State of the Environment Reports as a basis for evaluating progress in the implementation of environmental policies;
- Identifying and assessing those economic, investment, trade and other policies of the OECD area that have the greatest potential environmental impact, both within and beyond the OECD;
- Promoting the greater integration of environmental assessment in the development process;
- Encouraging harmonized approaches to environmental policy with a view, *inter alia,* to minimising trade distortions;
- Developing better information on the economic, social and trade dimensions of environmental policies; and sharing that information widely.

Follow-Up

The conclusions reached by the conference require careful examination and consideration by the Governments of OECD Member countries. They should be presented in an appropriate form to OECD Environment Ministers, when they meet in 1985 as well as to the OECD Council. The conference urges the OECD Secretariat to take suitable steps to this end.

International Tourism: First Signs of Recovery

International tourism reacts with a certain lag to changes in the level of economic activity. The slow, uneven 1983 recovery in the OECD area (from which the majority of OECD countries' international tourists come) did not produce any impact on the tourist market until the end of 1983 and the beginning of 1984. After stagnating for several years, international tourism in the OECD area is only now starting to expand again.

Although the difficult economic situation has not prevented the residents of OECD Member countries from taking holidays, it has made them more cautious about how they spend their money. This is reflected in shorter lengths of stay, increased use of secondary means of accommodation (such as staying with friends or relatives, camping and caravaning) and a growing tendency to holiday in countries closer to home or in places which have the attraction of favourable exchange rates or where competition has resulted in better value for money.

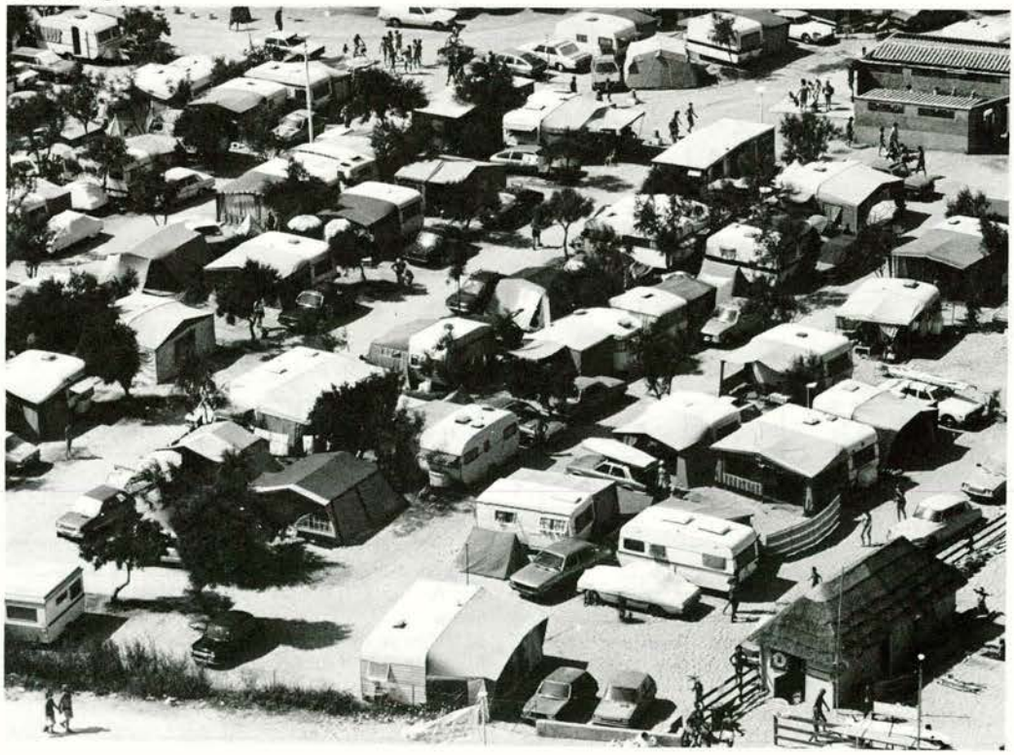
In response to this shift in demand, the industry is offering a wider choice than before, while competition has intensified between different destinations, service providers and means of transport. In view of the particular requirements of different social groups and the need to ensure the economic viability of the existing tourist infrastructure, Member countries have encouraged tourism for the young and elderly, they have promoted social tourism and they have extended the tourism season by staggering school holidays and by promoting off-peak vacations. There has also been an increase in co-operation through joint marketing efforts by destination – hotel operators, travel organisers and providers of tourist services, including transport operators. With the increasingly fierce competition in recent years between and within the various modes of transport, transport operators have been driven to re-think their operational approach and their overall strategy, resulting in a better match between supply and demand (which is in a state of flux).

In 1983, the flow of tourists, expressed in terms of arrivals at frontiers (in 15 Member countries) remained at the same level as the year before, whereas the number of nights spent by tourists increased by a further 1 per cent (in 18 countries, but not necessarily the same ones). This modest improvement compared to earlier years was due to a general rise in both categories of indicator in Europe and Japan/Australasia, which offset a decline in North America for the second year running. This was in part a result of the continued appreciation of the dollar vis-à-vis most other currencies and in part due to the slow recovery of the European market for trans-Atlantic destinations. For the first time since 1980, international tourist receipts in OECD Member countries as a whole did not decline, but stabilised at the 1982 level of $67.5 billion. Moreover, owing to the 5 per cent growth recorded in Europe (which accounted for 78 per cent of the total), receipts in real terms reversed the negative trend of 1982 (– 1 per cent) and rose by 4 per cent in 1983.

Overall, in the 15 Member countries which have data on the *number of foreign tourists who arrived at their frontiers* in 1983, there was virtually no change from the year before. Of the seven countries which reported an increase, it was the second year running for five of them. Portugal recorded a rise of 17 per cent (against 5 per cent in 1982), Japan 10 per cent (against 13 per cent), Iceland 7 per cent (against 1 per cent), the United Kingdom 7 per cent (against 2 per cent) and New Zealand 6 per cent (against 1 per cent). On the other hand, the biggest falls occurred in two Mediterranean countries – Greece and Italy, which both reported 4 per cent fewer arrivals. Another significant development was the turnround in Yugoslavia, where the number of arrivals increased by 5 per cent in 1983 after plummeting 13 per cent in 1982.

Similarly, the *number of nights spent by foreign tourists in hotels and similar establishments* in 1983 was unchanged from the

The economic situation has made tourists more cautious about how they spend their money. This is reflected in the increased use of "secondary means of accommodation" such as camping and caravaning.



previous year in the reporting countries. A 4 per cent increase in Spain (which represents 30 per cent of the total) was offset by a 2 per cent decline in Italy and a 1 per cent decrease in Switzerland. Exceptional growth was recorded in Sweden (up 10 per cent) and Turkey (with a jump of fully 47 per cent).

As far as *nights spent in all forms of accommodation* are concerned, there too the situation in those countries with data available was unchanged in 1983. Six countries reported an increase, three of them for the third year in succession. This was the case of Turkey (up 52 per cent), Sweden (+ 18 per cent) and Denmark (+ 3 per cent). On the other hand, declines were recorded for the second year running in Greece (down 6 per cent), Canada (– 4 per cent), Austria (– 3 per cent) and Switzerland (– 2 per cent), as well as Yugoslavia (– 1 per cent).

The breakdown of tourist flows from the four most important countries of origin (which accounted for nearly 61 per cent of the total number of arrivals and 45 per cent of the nights spent in 1983 in the OECD area) shows a substantial growth in the number of Americans (+ 8 per cent for arrivals and 6 per cent for nights spent) and

The tourist industry has responded to changing holidays".

of Britons (+ 2 per cent in both cases), a decline in the length of stay of Germans (– 4 per cent for nights spent) and a reversal of the positive 1982 trend for tourists coming from France (– 5 per cent for arrivals and – 6 per cent for nights spent). The rise in tourists from the United States to Europe was largely due to the favourable exchange rate of the dollar against almost all European currencies and to the low air fares offered on North Atlantic routes. The opposite occurred in the French tourist market, however, not only because the franc fluctuated against most other Member countries' currencies but also because the real disposable income of French households stagnated and currency restrictions were imposed on French residents travelling abroad from March to December 1983.

The volume of receipts in national currencies (and at current prices) rose in almost all Member countries in 1983, with the exception of Austria (down 3 per cent), the Netherlands (– 2 per cent) and Finland and the United States (– 1 per cent in both cases). In Japan, there was no appreciable change over the previous year.

In real terms (i.e. eliminating the effects of inflation and exchange rate movements against the U.S. dollar), total receipts from international tourism in the OECD area increased by 4 per cent in 1983. This was mainly due to a 6 per cent rise in Europe (after 2 per cent growth in 1982), which more than compensated for a 4 per cent decline in North America (following the 12 per cent slump in 1982) and for a 2 per cent drop in Japan/Australasia (reversing the 5 per cent improvement recorded the

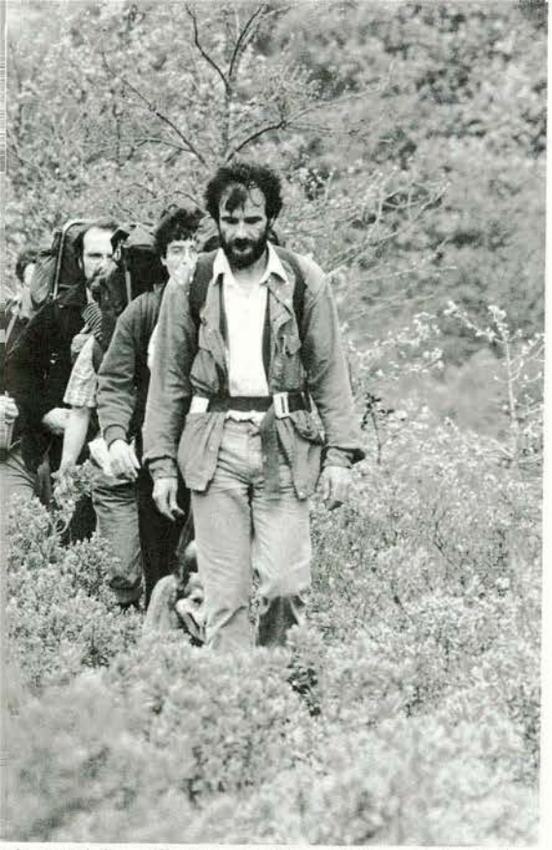
1. THE BASIC DATA

Percentage change over previous year

Country	Arrivals at frontiers[1]		Nights spent[2]		Receipts in national currency		Receipts in real terms[3]	
	1981-82	1982-83	1981-82	1982-83	1981-82	1982-83	1981-82	1982-83
Austria	–0.2	0.4	–2.8	–2.8	4.4	–2.7	–1.9	–6.0
Belgium[4]	. .	. .	18.7	–2.3	20.8	21.4	11.1	12.7
Denmark	. .	. .	3.8	3.3	21.6	9.8	10.8	2.7
Finland	. .	. .	–1.4	1.8	–7.0	–1.0	–15.1	–8.6
France	9.1	. .	–3.7	4.2	16.8	19.8	5.4	9.8
Germany	–0.3	–1.8	–2.2	3.5	–1.1	6.5	–6.0	3.4
Greece	–2.0	–3.8	–3.6	–6.1	(–5.2)	(1.5)	–22.1	–15.7
Iceland	1.0	6.9	. .	. .	98.6	117.2	29.0	18.7
Ireland	0.8	0.1	–0.5	8.3	14.1	10.1	–2.5	–0.8
Italy	11.0	–3.6	9.1	–3.5	31.4	21.7	12.6	6.0
Luxembourg[4]	. .	. .	. .	–2.1	20.8	21.4	11.1	12.7
Netherlands	. .	. .	4.5	–5.0	0.3	–1.9	–5.1	–4.2
Norway	. .	. .	–7.9	2.2	6.7	2.6	–4.7	–5.2
Portugal	4.7	17.4	0.7	. .	9.5	32.2	–10.6	5.3
Spain	4.7	–1.8	8.3	4.0	25.3	25.7	9.6	12.1
Sweden	. .	. .	1.5	18.3	30.3	28.2	18.3	15.9
Switzerland	2.2	0.0	–6.3	–2.1	2.8	7.6	–2.7	4.5
Turkey	–1.0	16.8	19.7	51.9	42.8	51.3	12.2	15.2
United Kingdom	1.6	7.4	1.0	6.3	6.7	15.4	–1.7	9.4
EUROPE[5]	1.4	–0.9	2.0	1.3	n.a.	n.a.	2.1	5.4
Canada	–4.9	1.4	–5.5	–4.1	–1.3	7.4	–10.9	1.4
United States	–9.4	. .	. .	. .	–7.2	–0.9	–12.2	–4.7
NORTH AMERICA[5]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	–12.0	–3.6
Australia	1.9	–1.1	. .	. .	(13.2)	(1.3)	2.6	–7.4
New Zealand	0.8	5.6	. .	. .	3.2	17.9	–10.5	12.8
Japan	13.3	7.8	11.4	. .	15.7	3.7	12.6	2.1
PACIFIC[5]	7.7	5.9	n.a.	n.a.	n.a.	n.a.	4.6	–1.7
OECD[5]	**1.3**	**–0.8**	**1.1**	**0.7**	**n.a.**	**n.a.**	**–0.3**	**3.5**
Yugoslavia	*–12.7*	*4.6*	*–10.4*	*–0.7*	*–4.3*	*67.0*	*–27.5*	*18.5*

1. Arrivals of tourists or visitors.
2. Nights spent in all means of accomodation except in Finland, France (Ile-de-France), Luxembourg the Netherlands, Norway, Spain and Japan where nights spent concern hotels and similar establishments.
3. After correcting for the effects of inflation and variations of exchange rates against the dollar.
4. Receipts apply to both Belgium and Luxembourg.
5. Overall trends for countries with data available from 1980 to 1983.

n.a. = not applicable.



demand by offering a wider choice of "activity

year before). The biggest increases took place in Iceland (+ 19 per cent), Sweden (+ 16 per cent), Turkey (+ 15 per cent), Belgium/Luxembourg and New Zealand (both up 13 per cent) and Spain (+ 12 per cent). On the other hand, there were sharp falls in real receipts in Greece (– 16 per cent) and Finland (– 9 per cent).

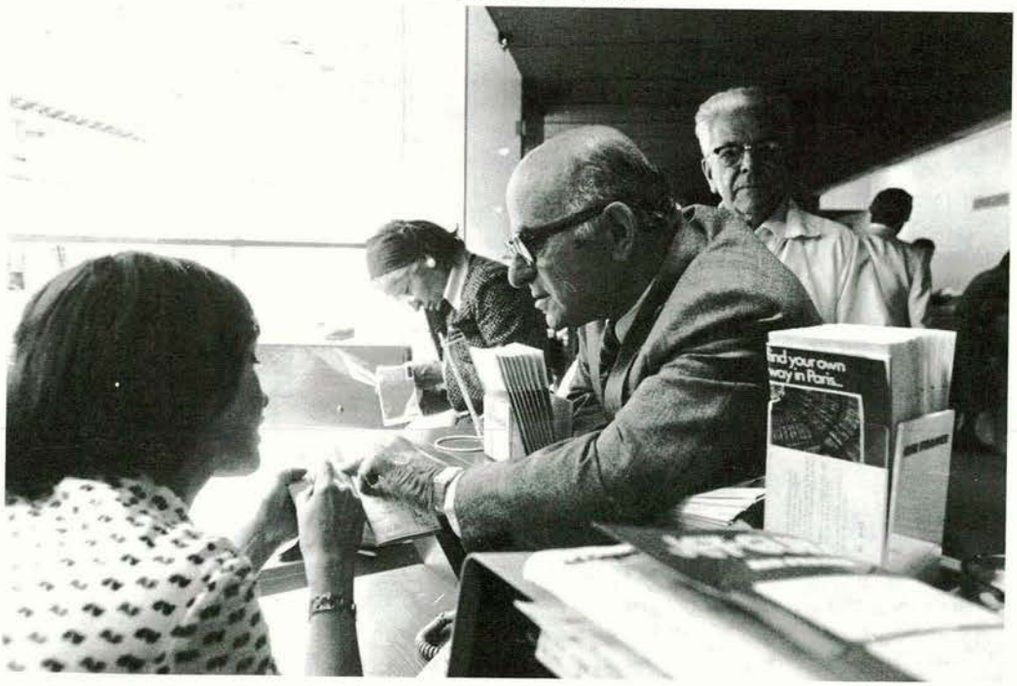
In the three years 1981-83, the overall tourism deficit of the OECD area fell from $2.2 billion in 1981 to $900 million last year. Europe increased its surplus during that period (from $4.5 billion to $7.2 billion), while the North American deficit soared from $100 million to $4.1 billion and the Pacific deficit declined a little from $4.9 to $4.1 billion.

Air Transport: The End of the Tunnel?

In 1983, after several very difficult years, the international air transport industry achieved a slight increase in profitability. Traffic growth was far from what it was in the previous decade, but it showed encouraging signs of recovery with 782 million passengers carried, i.e. a 3 per cent increase over the previous year. Capacity utilisation improved, being better adapted to demand. The maintenance (or reduction) in real terms of the fares offered to holiday-makers, plus the economic recovery in some of the principal countries from which tourists come, stimulated the demand for leisure travel by air. There is, however, some doubt as to whether the moderate improvement will generate a sufficient level of profitability to finance the heavy capital investment in fleet renewals that many airlines are having to make and the high associated interest charges. The tug-of-war between protectionism and excessive competition in an increasing number of regions has also increased uncertainty about the future growth and economic viability of the international air transport industry.

The other means of transport most utilised by tourists have also emerged from the depressed market brought on by the generally unfavourable economic situation in the early 1980s and by the vigorous competition that developed between transport sectors anxious to maximise their share of a virtually stagnant international market. The European railway industry has made a great effort to rationalise national networks and marketing operations so as to improve services to users, who represent an undoubted growth potential. Many obstacles still exist, however, and international organisations continue to assess the relative position of road and rail travellers so as to deal with problems arising in particular from administrative formalities (both before travelling and at frontiers).

The favourable exchange rate of the dollar and low air fares on North Atlantic routes explain the rise in the number of tourists from the United States to Europe.



NORTH ATLANTIC AIR TRAFFIC

19 688 000 passengers were transported on North Atlantic routes in 1983, i.e. 6 per cent more than the previous year. This reverses the unfavourable situation in 1982 (– 3 per cent) and marks a recovery that is better than the world average on the most important international traffic route in volume terms. After the exceptional 23 per cent rise the previous year, it was non-scheduled traffic that grew more slowly in 1983 (6 per cent). This was partly due to the introduction of promotional fares on scheduled flights, the increase in the number of airlines offering very low rates on their scheduled flights (e.g. People Express), and the fact that airlines traditionally providing charter flights began to offer scheduled flights (this was the case with several United States airlines, i.e. the "supplementals").

Because of the better adjustment to demand capacity, the load factors increased by two points on average to 71 per cent – 70 per cent on scheduled flights and 86 per cent on non-scheduled flights.

NORTH ATLANTIC AIR TRAFFIC (IATA et non-IATA)

Change in %

	79-80	80-81	81-82	82-83
Regular	+5.4	+3.7	–5.2	+6.4
Charter	–24.1	–6.9	+23.3	+5.7
Total	+1.0	+2.6	–2.5	+6.3

Source: International Air Travel Association (IATA), Geneva.

*
* *

After two difficult years, it seems that the modest economic recovery is bearing fruit and that tourism in Member countries as a whole has begun to benefit, especially since late 1983. For the revival to be really established in 1984, the efforts already made by international organisations and Member countries to resist protectionist tendencies need to be stepped up.

Source: OECD/Source: OECD/ Source:

NUCLEAR ENERGY

Total OECD nuclear generating capacity grew 11.6 per cent during 1983 to 160 GWe, compared with the 146 GWe achieved in 1982. OECD's Nuclear Energy Agency (NEA) estimates indicate that OECD nuclear capacity will rise to some 282 GWe by 1990 and about 392 GWe by the year 2000, although this latter figure depends on the rate of economic recovery (see table).

Although the nuclear share of total OECD electricity generation reached about 16 per cent in 1983, the situation between countries varied widely. The report notes that the difficult economic situation had caused energy planners in several countries to cut back nuclear projects, notably in France, Japan and Spain. Nevertheless, Belgium had a large increase: nuclear rose from 30.8 per cent of electricity generated in 1982 to 45.9 per cent while France maintained the greatest reliance on nuclear with 48.4 per cent of generation. Finland was third (41.5 per cent) and Sweden fourth (37 per cent).

NEA PROJECTIONS OF INSTALLED NUCLEAR CAPACITY WITHIN OECD *(net GWe)*

	Present Projected	*1983 Projected*	*1982 Projected*
1983 actual	160		
1985	201	209	216
1990	282	303	315
2000	392	450	489

Source: *Nuclear Energy Agency (NEA) Activities in 1983.*

STEEL

- In 1984, the recovery in world steel demand will be stronger and much more general than in 1983.
- In the OECD area, production, after a 24 per cent fall between 1980 and 1982, recovered in 1983 by only 2 per cent. In 1984, it is likely to recover by a further 8 per cent to over 360 million tonnes.
- The recovery in 1984 in demand and production will be strongest in the United States, Canada and Australia, the three countries experiencing the largest declines since 1979.
- The gap between maximum possible production and realised output in the OECD area is narrowing, but in 1984 it will still be some 110 million tonnes.
- The decline in employment in the steel industry in 1983 was less than in the previous year but still totalled about 100,000 jobs. Since 1974 the number of workers has fallen by around 666,000 or 34 per cent.
- In 1983, net exports to China from the OECD area more than doubled but those to other developing areas declined for the second consecutive year. Latin America, with a continuing decline in domestic demand, became for the first time a net exporter.

Source: *The Steel Market in 1983 and the Outlook for 1984.*

OIL

Energy demand in industrialised countries is projected to increase by one-third by the turn of the century. However, demand for oil, weak for the past four years, could well remain flat.

In 1983, the overall energy requirement of IEA member countries totalled 3,359 million tonnes of oil equivalent (Mtoe). By 2000, the needs could total 4,484 Mtoe.

Oil accounted for almost 44 per cent of the IEA energy "mix" in 1983. This share could decline to about 33 per cent by 2000 if projections are realised.

But demand for oil could rapidly revive unless IEA countries move forward in developing alternative energy sources – particularly coal and nuclear power – and improving energy efficiency.

Source: *Energy Policies and Programmes of IEA Countries: IEA Review.*

TAXES

Overall tax burdens are traditionally measured by the ratio of total tax revenues to GDP. Data just published by the OECD show that in 1982 Sweden, Norway, Belgium and the Netherlands had the highest ratios (all over 45) and the United States, Japan, Spain and Turkey the lowest ratios (all 30 or less).

Between 1981 and 1982 countries were about equally divided into those where tax burdens increased, decreased or remained stable. Provisional estimates for 1983 show that in eight of the 15 countries where data are available, the level of taxation increased; in three it fell and in four it remained more or less stable. It is noteworthy that over the three years 1981-1983, tax burdens have continually fallen in Austria, Finland, Germany and Norway and have continually increased in Canada, France, Ireland and the Netherlands. Since 1979, however, the increase has been almost universal.

TOTAL TAX REVENUE AS PERCENTAGE OF GDP AT MARKET PRICES[1]

	1979	*1980*	*1981*	*1982*	*1983**
Sweden	49.5	49.4	51.2	50.3	50.7
Norway	45.7	47.1	48.6	47.8	46.6
Belgium	45.6	44.7	45.2	46.6	n.a.
Netherlands	45.0	45.7	45.0	45.5	47.0
Denmark	44.5	45.5	45.0	44.0	46.1
France	41.1	42.5	42.7	43.7	44.1
Austria	41.2	41.3	42.6	41.1	41.0
Italy	30.5	33.2**	39.4	39.9	n.a.
United Kingdom	33.3	36.0	37.1	39.6	38.3
Ireland	33.0	35.9	37.8	39.6	40.6
Luxembourg	39.5	40.4	39.7	37.7	40.2
Germany	37.5	37.8	37.4	37.3	37.2
Finland	35.0	35.3	36.8	36.6	36.5
Canada	31.4	32.7	34.7	34.9	35.1
New Zealand	30.7	31.0	32.3	33.6	. .
Greece	27.7	28.6	29.2	31.9	. .
Australia	29.3	30.3	31.1	31.0	. .
Switzerland	31.1	30.8	30.6	30.9	n.a.
Portugal	26.1	29.3	31.5	30.8	33.0
United States	29.9	30.3	30.8	30.4	. .
Japan	24.8	25.9	26.8	27.2	. .
Spain	23.4	24.1	25.0	25.3	24.5
Turkey	20.8	19.0	20.4	20.1	23.7
Total OECD (Unweighted Average)	**34.6**	**35.5**	**36.6**	**36.8**	. .

1. *Ranked by the 1982 figures.*
* *Provisional.* *n.a. = not available.*
** *Break-in the series.* *. . = Partial data available only.*

Source: Revenue Statistics of OECD Member Countries 1965-1983.

Country Problems and Strategies of Four Countries: Canada, France, Germany and Japan

CANADA

Canada's recovery from its severest post-war recession, which came to an end in the last quarter of 1982, has exceeded initial expectations. Output growth in 1983 was greater than in the United States, but, because of the depth of the recession, production only regained its previous peak early in 1984. The government has at the same time succeeded in bringing inflation down to below the OECD average; it fell to a 10-year low of 4.2 per cent towards the end of 1983 and is still below 5 per cent, having peaked at around 12 ½ per cent in 1981. The external sector has remained buoyant, with the current account continuing in surplus. The federal government deficit is still uncomfortably high, however, at over 6 per cent of GNP.

Unemployment remains a particularly difficult problem for Canada. Its labour market is the fastest-growing in the OECD area, with an average annual increase of 2.6 per cent between 1960 and 1982 (as against 0.9 per cent for OECD countries as a whole). While employment has increased, job creation has not kept pace with labour supply and the Canadian unemployment rate has consistently been above the OECD average. It peaked at 12.8 per cent in late 1982 and remains at around 11 ½ per cent.

Industry has benefited from a sharp improvement in profits with the return to higher levels of activity, but since capacity utilisation remains low, firms have shown no interest in investing in capacity expansion. The Canadian economy remains relatively dependent on resource-based industries, and many of these sectors suffered sharp falls in demand and prices during 1981 and 1982. Commodity markets are traditionally volatile, but the fall in consumption during the last recession was particularly acute. The peak to trough decline in metal mining and resource-based manufacturing ranged from one-quarter to over a half, compared to an average of 20 per cent for manufacturing as a whole. Many of these markets remain relatively depressed, moreover.

Canada's primary industries account for 10 per cent of GDP, but if manufacturing activities involving a relatively low degree of raw material processing are included, the total is closer to 20 per cent. The resource-based share of traded goods output was about the same in 1981 as in 1961 (around 60 per cent), after having fallen to 55 per cent in 1971. Mining is dominated by the oil and gas industries, which account for almost two-thirds of the value of production, while each of the major metals has a share of 3 to 3 ½ per cent. Forest products forms the country's largest industrial sector, however, employing 300,000 people and contributing about one-eighth of traded goods output. While there is a high degree of vertical integration between non-ferrous mining and smelting/refining operations, forest products are divided into two distinct sectors – wood, pulp and paper.

Canada's natural resources are spread across the country. British Columbia accounts for nearly a half of forestry activity, while pulp and paper production is concentrated in Ontario and Quebec, with each province accounting for roughly one-third of output. Ontario is also strong in metal mining and accounts for over one-half of basic metals production, followed by Quebec (one-quarter). Petroleum is the major activity in Alberta, which contains most of the country's most easily recoverable oil and gas reserves. The hydrocarbons industry in fact contributes the bulk of the economic rent generated by Canada's resource industries, and a major objective of the National Energy Program has been to

Canada exports large quantities of wood, pulp and newsprint in relatively unprocessed form, with the result that its economy is deprived of the benefit of added value through further processing.

ensure a more even geographic distribution of its benefits.

Canada's comparative advantage in the extraction and primary processing of indigenous resources is evident from the structure of its trade. In 1981, resource-based industries accounted for close to 60 per cent of merchandise exports but only 30 per cent of imports, compared to 30 and 50 per cent respectively for the OECD as a whole. It had a surplus of US $20.6 billion on its trade in resource-based commodities, of which metals and forest products accounted for two-thirds. At the same time, though, these industries are highly dependent on foreign markets. Canada is by far the world's largest exporter of lumber, pulp and newsprint, but the bulk of these exports is in relatively unprocessed form, depriving the economy of the benefit of added value through further processing.

Some of Canada's resource-based industries are suffering from weak demand worldwide and growing competition from other producers. Metal-mining was one of the fastest-growing sectors of the economy up to the early 1970s, but has been on a declining trend since 1973. Despite rising profits, output during the 1979-80 international boom fell short of the previous peak by some 20 per cent. The subsequent recession brought substantial losses and production was cut by one half. Even now, copper prices allow only very high grade mines, or those with by-products, to remain in operation. The decline in output growth was also associated with a slowdown in productivity growth, which was particularly noticeable in the energy sector as well as in forestry and mining. Nevertheless, the upsurge in prices in 1979-80 resulted in higher profits, but investment has continued to be inadequate, even though the growth rate of the resource industries' capital stock recovered towards the end of the 1970s.

The effects of the 1981-82 recession were aggravated for Canadian pulp and paper producers by the Swedish and Finnish devaluations of late 1982, which came on top of the rise in the effective exchange rate of the Canadian dollar. While North American pulp producers continued to register losses in 1983, Swedish mills enjoyed operating profit margins of 14 per cent last year. Canadian newsprint factories could manage returns of only 1.2 per cent (British Columbia Coastal) and 3.2 per cent (Quebec), as against 18.2 per cent for Swedish producers.

The prospects are not particularly bright for Canada's resource-based industries. Canada's share of the world newsprint market has been declining for the last 10 years, mainly as a result of competition from low-cost producers such as Brazil, Chile, New Zealand and South Africa. The United States is also becoming increasingly self-sufficient in some of Canada's major forest products. In addition, the Canadian industry is now facing difficulties because Scandinavian exports to the EEC have been free of tariffs since the beginning of 1984. In the longer term, world demand for minerals and forest products is forecast to grow more slowly over the coming two decades than in the past. In terms of product mix, the future trend could be particularly unfavourable to Canada insofar as demand will be strongest for the more processed, high quality commodities than for basic lumber and newsprint. The mineral industry expects world demand in the 1980s and 1990s to grow at less than half the rate attained in the post-war period up the the mid-1970s.

Canada has every incentive to take advantage of its rich endowments of natural resources to ensure its long-term economic prosperity. Its resource-based industries now seem to be resolved to stem the erosion of their competitiveness and have started to modernise their capital stock through the adoption of new technologies. Their economic performance reflects Canada's comparative advantages, and their adaptation to new technologies and to the challenge from new sources of supply in the developing world must be considered an integral element in the overall positive adjustment of Canadian industry. The likelihood that the resources sector will offer only limited scope for future expansion may have tended to focus industrial initiatives in other manufacturing areas.

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In the immediate future, the Canadian recovery is forecast to continue at a little above the average rate of output growth for the OECD area. GNP is expected to grow by 4½ per cent in 1984 and 3 per cent in 1985, but the unemployment rate will remain at around the 11 per cent mark. Inflation is expected to stabilise at about 5 per cent, corporate profits should continue to improve and business investment will pick up as a result. The trade surplus is forecast to increase to $18½ billion in 1984 and 1985, well above the record of $15.4 billion set in 1982, while the current account surplus is expected to widen to 0.7 per cent of GNP in 1984 (from 0.4 per cent in 1983).

Fiscal policy will continue to follow the medium-term strategy adopted in April 1983 and reaffirmed in the February 1984 budget. The main aim was to assist the incipient recovery, and that has been achieved. Now the priority should be given to reducing the federal deficit, although weak private sector demand for credit has meant that financing the deficit has not so far posed a problem.

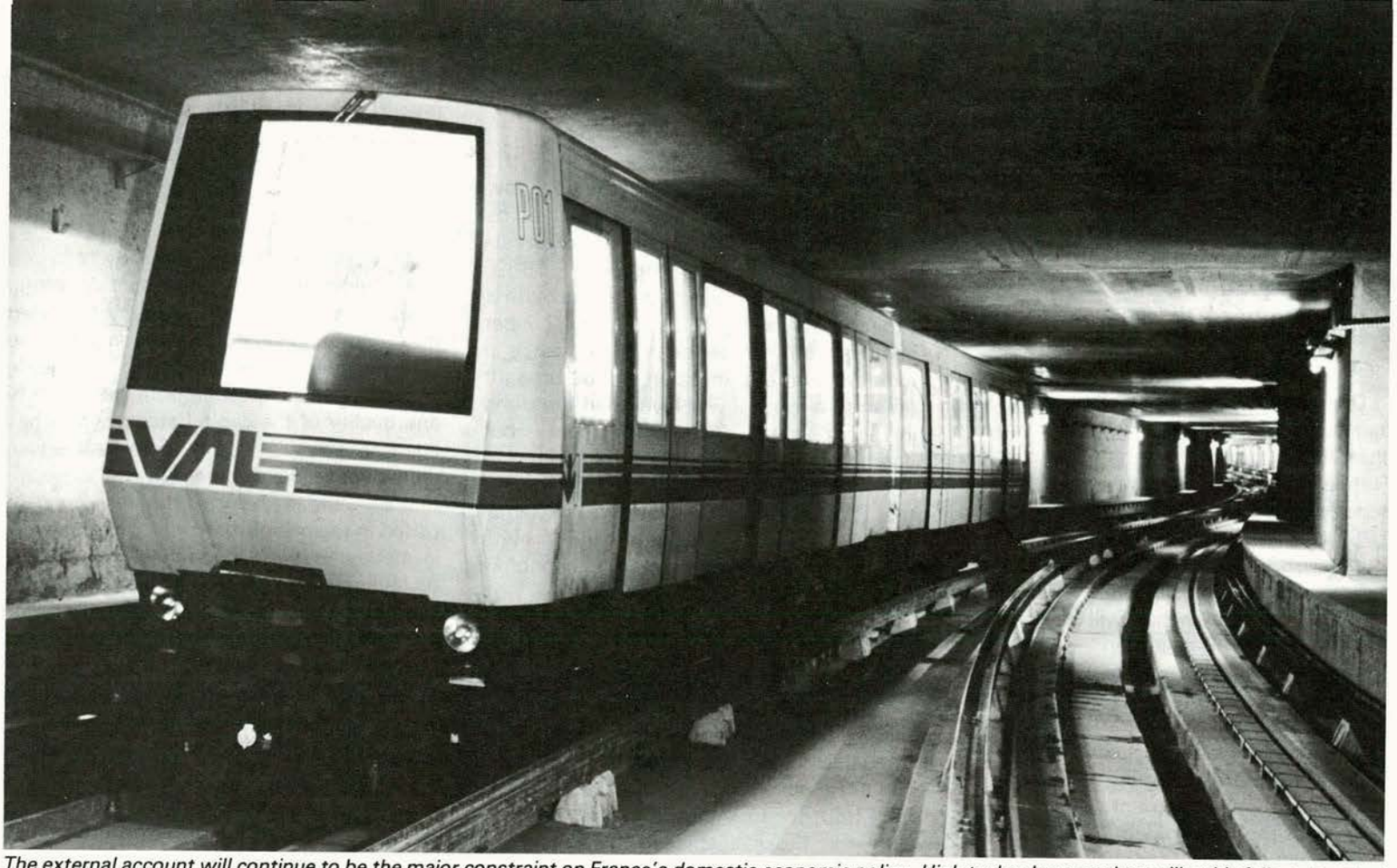
FRANCE

The sharp deterioration in the external account and a persistently high rate of inflation led the government to radically alter its economic policy in June 1982, a year after taking office. The stance of monetary and fiscal policy was tightened and a comprehensive prices and incomes policy was introduced. The result was a rapid improvement in inflation and the external deficit. The year-on-year inflation rate was brought down from 11.8 per cent in 1982 to 9.6 per cent in 1983. The trade deficit was halved, with the current deficit dropping from $12 to $3.8 billion over the same period.

These results were obtained at the cost of a marked slowdown in activity. Whereas the French economy grew substantially faster than the OECD average in 1981 and 1982, the situation was reversed in 1983 when France's GDP grew by only 0.7 per cent compared to an average of 2.4 per cent for OECD countries as a whole. Employment support programmes succeeded in keeping unemployment at around the two million mark for most of 1983, but the number of jobless started to rise appreciably from the last quarter of 1983 on, and is expected to go on rising through 1984 and 1985, to 10.5 or 11 per cent of the labour force.

The future performance of the French economy will depend on its foreign trade, and the external account will continue to be the major constraint on domestic economic policy. There are reasons for thinking that the improvement in the foreign balance in 1983 may have been due, in large part, to the fact that France and its main trading partners are cyclically out of phase while the improvement in the competitiveness of the productive system was limited.

The improvement in the trade balance last year was mainly due to volume trends, with exports increasing by 4.1 per cent and imports declining by 1.7 per cent. Part of the improvement was also due to a shift in the terms of trade. The positive developments in France's foreign trade were primarily a result of the devaluations of the franc in June 1982 and again in March 1983 and of measures to dampen down the increase in domestic demand, but they were also a consequence of the recovery in French export markets. The devaluations reduced French industry's relative labour costs by 6.1 per cent in the



The external account will continue to be the major constraint on France's domestic economic policy. High technology products, like this fully automated metro system in service in Lille, are among those which carry French hopes for improved export performances.

space of 12 months; for 1983 as a whole, they were at their lowest level since 1978, the last year in which France's foreign trade was in surplus. The resulting improvement in French exporters' price competitiveness, combined with the fact that domestic demand in France fell by 0.4 per cent in 1983 while demand in the OECD area as a whole increased by 2.5 per cent, enabled French manufacturing industry in 1983 to regain foreign market shares it had lost in 1982.

Cyclical trends and the return to competitiveness are contributing to further progress on the foreign trade front in 1984, but structural problems still persist which, if not corrected, will have a negative impact on the medium and long-term development of France's external trade. French manufacturing industry has lost export market share at a rate of 0.5 percentage points a year since the first oil shock, whereas it had been gaining 1.7 percentage points annually until then. In value terms, France's share in OECD area merchandise exports rose from 7.8 per cent in 1960 to 8.9 per cent in 1973 and to over 9 per cent in 1979, but thereafter it declined progressively to 7.9 per cent in 1983. Unlike other OECD countries which are dependent on imported energy and raw materials, such as Germany and Japan which have continued to boost exports even since the second oil shock, France has seen import shares grow faster than export shares.

Foreign penetration of the French domestic market has occurred in all sectors, albeit to varying degrees, and the pace has not slackened since the second oil shock. For capital goods, the rate of import penetration was 50 per cent in 1983, and for intermediate goods 35 per cent. Hence, in the event of a general recovery in economic activity, one-third of the benefit would go to foreign industry, while half of any pickup in investment would represent increased business for foreign suppliers. Import penetration has risen more rapidly in the last five years than in the preceding five, especially in capital goods and household durables. The real rate of import penetration in the industrial capital goods sector increased by 11 points between 1978 and 1983, whereas it had gone up by only five points in 1973-78; in the case of household durables, import penetration rose by 12 points in 1978-83, after climbing by only four points in 1973-78. At the same time, the real rate of growth in French industry's export ratio slowed to around one point in 1978-83 after recording eight points in 1973-78. In some sectors, moreover, such as automobiles and land transport, the export share is now lower than before the first oil shock. The contribution of the real trade balance to the growth of industrial output was generally negative over the 1974-83 period, therefore.

Until 1980, the growing weakness of France's merchandise exports was offset by the remarkable buoyancy of its trade in services. Net earnings from transport, tourism and technology trade represented 27 per cent of total export revenues in 1982. That year, France accounted for 17 per cent of the service exports of the seven major industrialised countries, compared to 36 per cent for the United States, 13 per cent each for the United Kingdom and Germany and 11 per cent for Japan. Within the general services sector, tourism has been particularly healthy recently; the tourism surplus almost tripled between 1981 and 1983 in French franc terms, owing both to the successive devaluations and to the tightening of foreign exchange controls. Enormous strides have also been made over the past 10 years in technology-related services, the surplus on which has soared from FF 1 billion in 1973 to FF 12 billion in 1978 and FF 30 billion in 1982-83. Overall, though, the service surplus has been on the decline since 1980, largely as a result of the sharp increase in interest payments.

Partly thanks to the strength of the trade in services, France's current payments balance was in surplus in 1978 and 1979, but swung into deficit from 1980 onwards. The deficit on current account represented 0.6 per cent of GDP in 1980, but this widened sharply to 2.2 per cent of GDP in 1982, before falling back to 0.7 per cent in 1983.

The French franc has stabilised since the last devaluation in March 1983, remaining close to its central rate in the European

Monetary System (EMS). Like other currencies, however, it has depreciated against the dollar (by 10 per cent over 12 months). After rising steadily between 1978 and 1981, the real effective exchange rate of the franc had been reduced to 5.4 per cent below its 1978 level by April 1983. With the rise in the dollar, the real rate has fallen further, however; between April 1983 and April 1984, the real rate was 6.8 per cent below the 1978 average.

One result of the increased budget and balance of payments deficits has been a sharp rise in net foreign borrowings. France's external position has swung from a net surplus of FF 21.1 billion francs in 1981 to a net deficit of almost FF 200 billion in 1983. Servicing this debt absorbed 4.4 per cent of total export earnings in 1983; debt repayments will peak at an average of FF 88 billion in 1988-1990, when they will account for between 3.8 and 5.1 per cent of export earnings, depending on whether exports grow by 10 or 5 per cent in value over the 1984-1990 period. Hence, the magnitude of the macro-economic constraint constituted by the size of the foreign debt will depend on the development of France's current payments position.

Clearly, the marked improvement in the trade balance in 1983 was not able to change the adverse structural trends in the external sector. Long-term developments such as the substantial import penetration in capital goods is leading to a misalignment between the development of French industry and that of its domestic and foreign markets, so that any boost to the economy tends to be reflected in a trade deficit. With outstanding foreign debt now equivalent to 11.4 per cent of GDP, in gross terms, the only way for the external constraint to be eased is for the productive system to be better adjusted to the pattern of domestic and foreign demand.

The adjustment of French industry is not helped by the fact that its profitability has been falling. The deterioration of industrial companies' financial positions dates from the first oil shock and explains the ageing of France's industrial base. It was only in 1983 that corporate profitability started to improve; between 1973-74 and 1982-83, French industry's profit ratio (defined as gross operating surplus/value added) declined by over 10 percentage points, while it remained more or less stable on average for the seven major OECD countries. Companies have had to increase borrowings as a result; their self-financing ratio dropped below 50 per cent in 1982 from around 64 per cent in the early 1970s. Another consequence has been the fall in the investment ratio, which plunged from 23 per cent in 1974 to 11 per cent in 1982.

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The medium-term prospect for the French economy is for continued low growth which needs to be accompanied by a shift in resources to profits and investment. Looking to the horizon of 1988, when the 9th five-year plan ends, growth is expected to pick up to as much as 2.7 per cent, but only in response to buoyancy in external markets. Inflation will be brought down to a much lower level than the trend in recent years – 3 to 5.8 per cent – but unemployment will climb steadily to between 2.5 and 2.9 million. That implies that the slow growth path to external equilibrium will impose a negative growth differential on France vis-à-vis its economic partners.

The impact on employment can only be limited by greater flexibility in the wage formation process and in the labour market. The shift in relative costs could also induce businessmen to invest in labour-intensive sectors like services, which offer the greatest opportunity for creating new jobs both for new labour market entrants and for those displaced by traditional industry. It will certainly be necessary to continue and build on the progress achieved in 1983 in terms of the disindexation of wages and the greater flexibility allowed to labour management. Only then can balanced and sustained growth be restored to the French economy.

GERMANY

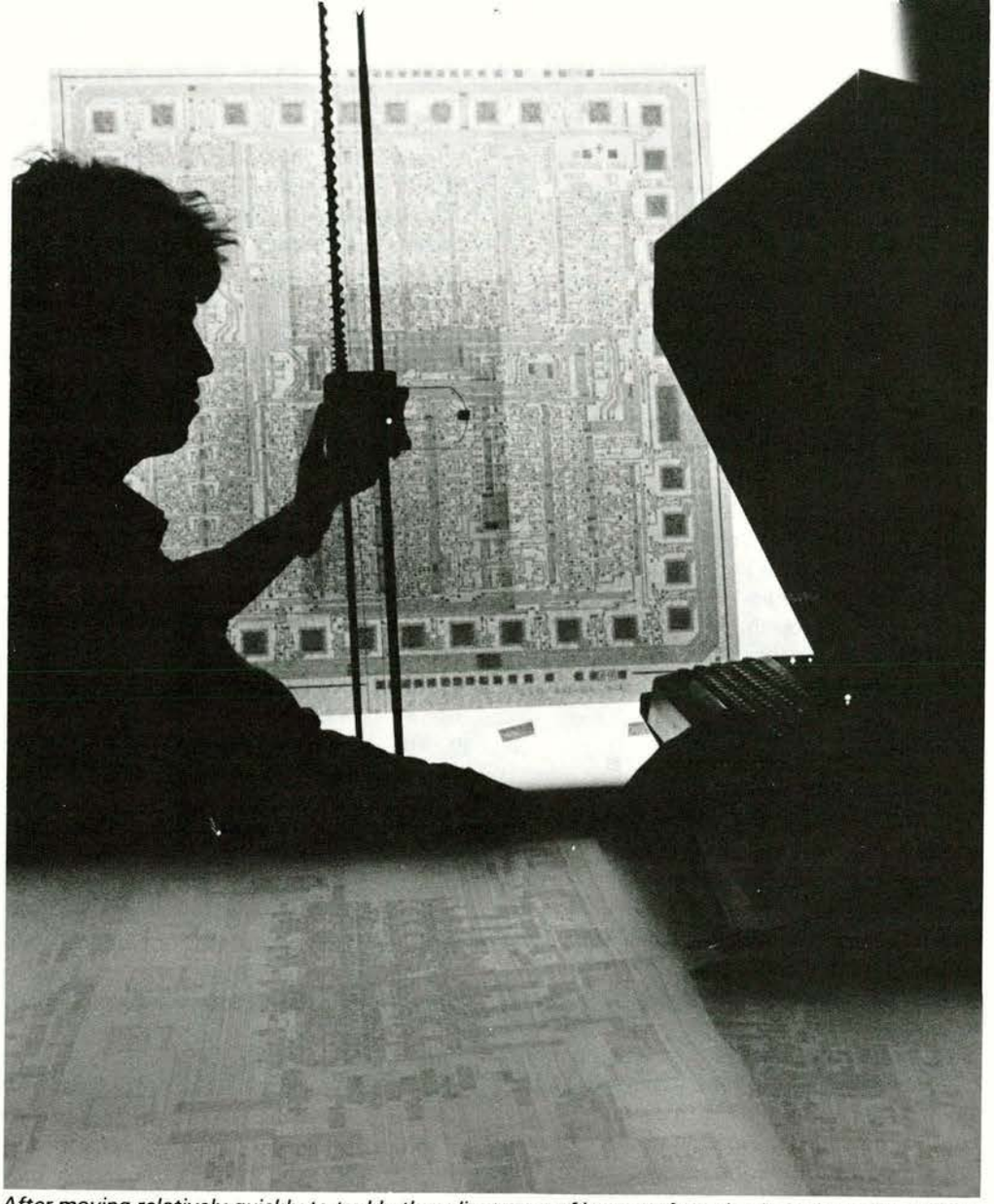
The German economy started to pick up at the beginning of 1983, following a recession that had lasted nearly three years, and by early 1984, real GNP exceeded the pre-recession level. Inflation has declined further the public sector deficit has been reduced and the current external account has moved into surplus. Monetary and fiscal policies have remained restrictive, however, and the recovery has been modest compared to previous upswings. As a result, employment has hardly increased, and the jobless rate of 8.2 per cent in May 1984 was barely lower than the peak recorded in mid-1983.

Although short-term forecasts point to a continuation of the recovery over the next 18 months, GNP growth will remain insufficient to produce any significant improvement in the labour market situation. The main challenge for the authorities, therefore, is to transform the recovery into a sustained non-inflationary expansion sufficient to achieve an appreciable reduction of unemployment. With cyclical trends more favourable, this implies that Germany must turn its attention to areas of the economy where the adjustment process since the two oil shocks has not been entirely satisfactory.

After moving relatively quickly to tackle the adjustment of its manufacturing industry in the 1970s, Germany has seen the adaptation of its production structure slow down. Investment has been inadequate in recent years, affecting both the quantity and quality of the capital stock, which has aged as a result. There has also been an unfavourable development in the composition of German exports; they are concentrated in regions of the world where growth is modest and are not faring well in high technology sectors. One of the reasons for Germany's unsatisfactory industrial adjustment is low profitability and the weak financial base of its companies.

The downward trend in profitability can be traced back to the late 1950s and recent developments have not done much to reverse the situation. German industry has roughly followed the international average, though depressed profitability in the early 1980s was essentially due to cyclical factors, accentuated by the rise in real interest rates. The net operating surplus of non-financial enterprises fell by 11 percentage points as a proportion of net value added between 1960 and 1975, from 46.5 to 35.5 per cent. Wage moderation in the recent recession enabled profitability to increase in 1982 and 1983, however, with the net operating surplus recovering to 37.8 per cent of net value added last year. This represents a much sharper improvement than occurred in the last upswing from 1976 to 1979.

Corporate balance sheets have weakened considerably since 1968, with own funds (capital plus reserves) falling from 30½ per cent of total assets to 18½ per cent in 1982. Apart from low profitability, there are two main reasons for this development. Firstly, when corporate enterprises buy unincorporated ones (whether by using their own funds or raising credits), that constitutes a transformation of own funds into financial assets of households. Secondly, the German equity market remains underdeveloped in comparison to other large industrialised nations, so there are problems when it comes to raising risk capital. In 1982, the total share capital of quoted companies in Germany amounted to only 6 per cent of GNP, whereas it represented 55 per cent of GNP in the United States, 36½ per cent in the United Kingdom and 17 per cent in Italy. Over the past 15 years, capital raised in the stock market has never contributed more than 5 per cent to the external funding of German corporations. The small proportion



After moving relatively quickly to tackle the adjustment of its manufacturing industry in the 1970s, Germany has seen the pace of adaptation of its production structure slow down. Above: computer aided design at a Siemens factory in Villach.

of own funds in corporate balance sheets makes companies vulnerable to fluctuations in demand and interest rates, as illustrated by the sharp increase in bankruptcies in the past few years. Moreover, the virtual non-existence of a venture capital market inhibits structural change, as small and medium-sized companies find it hard to raise finance for innovative investment.

Whether the low rate of investment is fundamentally a supply or demand problem, there is no doubt that it has been inadequate in recent years, so that unemployment is now essentially a structural problem arising from industry's failure to adjust. Between 1974 and 1983, private sector investment grew by only 2 per cent a year on average, compared to a yearly average of 4 per cent in the 1960-73 period. As a result, the capital stock is now insufficient to employ the labour force. The rate of investment is influenced, among other things, by the level of capacity utilisation; with the strong pick-up in capacity utilisation after the recession of the mid-1970s, for instance, there was a sharp increase in business fixed investment, especially in machinery and equipment, whose yearly growth rate was over 6 per cent in the four years to 1979. However, that reflected the slow growth in potential output after the first oil shock (about 2 per cent a year, half the rate of the previous years), which meant that capacity utilisation rose rapidly. The latest recession was longer but flatter than the previous one and capacity utilisation apparently remained above its 1975 level throughout. Hence, the recovery has been less steep than in the mid-1970s. GNP growth of 3 per cent in 1984 and 1985, as forecast by the OECD, would still leave capacity utilisation below "normal", even though capacity is growing at less than 2 per cent a year.

Government subsidies to industry are coming under increasing criticism as disincentives to structural change, although in many cases they were introduced specifically to facilitate structural adjustment. Although subsidies to agriculture, food processing, mining, railways and shipping were cut between 1979 and 1982, these sectors, together with the wholesale trade, accounted for over half of total subsidies to industry in 1982. Aid to the depressed shipbuilding and iron and steel industries increased sharply, but still accounted for only a small part of the total. An independent report concluded recently that, of the main sectors to benefit from state subsidies, only aerospace could be considered an example of positive adjustment. Other sectors where government support has been negligible, such as the clothing industry, have shown far greater dynamism in adapting to changing conditions. There is widespread agreement that in the majority of subsidised sectors, financial aid has become self-perpetuating, without contributing to the adjustment process. While the government intends to reduce subsidies, abolish many regulations and rely more on market forces to allocate resources, some recent measures designed to stimulate investment (tax concessions and incentives, special depreciation allowances, and so on) have in fact raised the level of subsidisation. Financial assistance rose in 1983, after falling the year before, and is expected to increase further this year.

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The immediate prospects for the German economy are for continued recovery at a modest rate, with GNP growth fluctuating between 2½ and 3 per cent after a temporary spurt in the first quarter of this year. Domestic demand is projected to weaken a little, but export demand is expected to pick up, although German export markets will continue to grow less rapidly than world trade as a whole (whose rate of growth is forecast to decelerate slightly over the next 18 months to an annual 5½ per cent). As the recovery develops, productivity growth will slow down, so employment should increase a little over the next year or two. But the labour force is also expected to expand again, so the unemployment rate will not fall much. The current account surplus should continue to grow, however.

The government has been concerned to reduce the public sector deficit and it succeeded in cutting it to about 2 per cent of GNP in 1983, from a peak of 4 per cent in 1981. On present budget plans, the policy of fiscal consolidation will continue in 1985, when the public sector deficit may come down to around ½ per cent of GNP. That would mean that, on a cyclically-adjusted basis, the public sector may have moved into a position of substantial structural surplus. That has opened the way for a supply side tax reform which the autho-

rities plan to introduce in the 1986-88 period. The object is to reduce or eliminate distortions due to the level and pattern of taxation with a view to improving the functioning of the economy. While the government will have to watch the short-term demand effects of the tax reform, it may result in an improvement in medium-term growth conditions. In any case, the government will have to adjust policy to counter any excessive slowdown in the recovery and continue to strive for a rate of growth sufficient to bring a steady fall in unemployment, which would also ease the task of removing the barriers to structural adjustment.

JAPAN: LIBERALISING FINANCIAL MARKETS

Extensive controls on Japanese financial markets – domestic as well as international – have been gradually eased during the last decade, and this evolution has gathered speed during the last couple of years both for domestic and for international reasons. In the aftermath of the Second World War, regulations were imposed on all private financial institutions which were in turn protected by the authorities. Competition between different institutions was strictly limited, interest rates controlled and internationally tight capital controls were applied. The system smoothly financed the radical post-war transformation of Japan. Up to the early 1970s, the financial system was still highly regulated, segmented and relatively isolated internationally. Household savings were generally deposited in banks at low controlled interest rates. Banks in turn financed the corporate sector's financial deficit which was particularly large given the high investment ratio. As interest rates were often held to below equilibrium levels, the supply of credit was rationed by the banks, and the corporate sector had little direct recourse to open capital markets. Moreover, relatively little credit was made available to the household sector, and the government sector did not generally borrow in open markets. Overall only about 10 per cent of total funds raised in financial markets came from capital markets.

This policy of satisfying the corporate sector's large appetite for funds at low interest rates (the so-called "artificial-low-interest-rate" policy) was able to continue for a number of reasons. First, the range of "safe" domestic financial assets available to households and other creditors was limited. In marked contrast with most OECD countries, no government long-term bonds were issued at all until 1965, and a large number of issues started only in 1975. Secondly, an extensive system of controls and agreements limited competition and prevented competing financial institutions from "bidding-up" interest rates. Finally, extensive capital controls under the fixed exchange rate regime limited both inflows and outflows of capital. Households were therefore prevented from seeking higher interest rates abroad. Equally, Japanese corporations were not able to escape domestic credit restraint by borrowing abroad. In sum, although Japan's financial system was not market oriented, it played a key role in the capital formation process and the achievement of a high rate of growth, with the benefits of stability outweighing the costs of the various controls.

Domestic Pressure for Change

During the last decade, however, major structural changes in the macroeconomic climate following the first oil shock and the end of what the Japanese call the High Growth Era have put this system under increasing pressure. The investment ratio fell sharply, reducing the corporate sector's need for borrowed funds. At the same time, the household saving ratio rose from about 18 per cent in the 1960s to around 20 per cent in the 1970s. The counterpart of net private domestic saving was an important government deficit, financed by large issues of government bonds.

The number of central government bonds outstanding rose from less than 10 per cent of GNP in the mid-1970s to over 30 per cent by the early 1980s. These developments meant that the size of the Japanese secondary market for bonds was, by the end of the 1970s, second only to that of the United States. The more efficient operation of this market is evidenced by the fact that price spreads between buying and selling rates have tended to narrow in recent years, although they still remain much higher than those in United States markets. Moreover, the emergence of this large secondary market in government bonds in turn stimulated the development of freer short-term money markets.

First the Gensaki market – based on trading in government bonds – developed during the 1970s to provide non-bank short-term financing. But as an increasing number of corporations switched their liquid funds from bank deposits to more attractive Gensaki instruments, the banks were allowed to issue alternative, and competing, financial instruments. Negotiable certificates of deposit (CDs) were permitted in May 1979, and secondary trading started in April 1982. Although the range of financial assets available in short-term money markets is now much wider, there is still no Treasury bill market in Japan. Government short-term securities are different from Treasury bills in other countries; their role is limited to cash management, and they are largely subscribed by the Bank of Japan at rates set slightly below the discount rate. However, an increased quantity of government bonds with a year or less to maturity will be on the market during the 1980s, and this may create an effective market for government securities of a short-term nature. Furthermore, the need to refinance large-scale government debt as from fiscal year 1985 will call for a diversification of the range of government debt instruments.

The rapid development of bond and money markets has led to gradual changes in the Japanese financial system, with market-determined interest rates now co-existing with regulated rates. But there have not been dramatic shifts of funds to market instruments from financial institutions, mainly because relatively large minimum amounts were required in the free markets. And since, without special permission, Japanese residents are still prohibited from holding interest-bearing bank accounts abroad (but not in Japan) for investment purposes, households are not able to take full advantage of freer external markets. The minimum transaction amount in the Gensaki market is Y 100 million (about $400,000 at current exchange rates) and that for CDs is still around Y 300 million ($1,200,000), soon to be reduced to Y 100 million. Nevertheless, increased liberalisation has enhanced competition and put some pressure on the profitability of lending by the various financial institutions.

Until very recently, these institutions were rather segmented, both as to their traditional permitted method of collecting funds and as to their customers. A particularly important rule was that banks were not allowed to undertake security business, and *vice versa*. City and regional banks were allowed to grant mainly short-term loans, long-term credit banks being largely responsible for long-term loans. However, this traditional segmentation of Japanese financial institutions has come under considerable pressure from increased liberalisation. City banks now make more long-term loans while long-term credit banks have expanded short-term loans. After banks were allowed to sell government bonds, the security companies in 1980 introduced a medium-term government bond fund ("Chyuki-kokusai fund"). Since then, banks, trust banks and long-term credit banks have been permitted to issue various high-yield instruments. The interest

rates that can be earned on such instruments have moved closer to market interest rates. The counterpart of this is that profit margins on lending by the major financial institutions have declined sharply. These pressures are the natural consequence of liberalisation and will in time improve the efficiency of financial institutions. Large and efficient banks may well be able to withstand this squeeze. But the smaller, less efficient banks may have a harder task, and may need time to adjust to the new climate. Preventing bank failures or disruptions is naturally an important concern of the authorities, and this concern underlies their desire for steady, orderly change in Japan's financial system.

Greater International Openness

The gradual evolution of freer financial markets domestically has been accompanied by greater freedom for international capital transactions. The emergence of Japan as a net capital exporter contributed to the pressure for change. Up to the mid-1960s, rapid growth led to periodic balance of payments crises which typically necessitated measures to restrict demand, and the current account was widely regarded as a significant constraint on growth. But from the latter part of the 1960s onwards, Japan's current account tended to show a persistent surplus (of around 1 per cent of GNP), a tendency that was only interrupted by successive oil price shocks. During the last decade, restrictions on inward and outward capital flows have gradually been relaxed. Until recently, concern about maintaining an appropriate exchange rate influenced the pattern of liberalisation. When the yen was weak, inward movements of capital were encouraged, and outward movements discouraged. Nevertheless, the general trend towards greater liberalisation was evident. Indeed it gathered pace towards the end of the decade, culminating in a new Foreign Exchange and Foreign Trade Control Law (December 1980) which established the general principle that external transactions be decontrolled, subject to certain residual restrictions as well as prudential guidelines and emergency clauses. This new step was particularly radical in that it was the authorities' stated intention not to reinforce controls for exchange rate reasons. And despite a sharply falling yen in 1981 and 1982, restrictions were not in general reimposed. Moreover, the intent of this legislation was supported by a number of specific measures. The result was a large jump in *both* inward *and* outward capital flows. The fact that in 1981 and 1982 both inflows and outflows remained high by historical standards is in marked contrast to earlier liberalisation periods. However, outflows of Japanese capital swamped inflows of foreign capital, partly because of prevailing exchange rate and interest rate expectations. The diversification by Japanese portfolio managers into foreign currency assets, and disinvestment in yen assets by some OPEC members were also significant influences. Controls in Japanese financial markets may also have played a part – although recent changes have been significant – Japanese financial markets and institutions are still much more regulated. The existence of largely liberalised markets overseas (and particularly in the United States and in Euromarkets) meant that Japanese investors could find readily available foreign assets once foreign transactions were freed.

The Japanese authorities have therefore taken further important steps to make financial markets more open to non-residents. The recently announced agreement between Japan and the United States should contribute to further widen the range of financial assets available to both domestic and foreign investors, and promote greater internationalisation of the

The Tokyo stock market.

yen. Although certain significant impediments still exist, and it will be some time before the full impact of recent measures is evident, there can be little doubt that the yen is becoming more firmly established as a major international investment currency. The impact of recent changes on the exchange rate is uncertain. Although *some* effect is possible, it would probably be unrealistic to expect a *major* impact.

Nevertheless, the international provision of financial services may be improved. Greater foreign competition in the provision of financial services in Japan should make Japanese financial institutions more efficient. Indeed, the achievement of greater efficiency is the main reason for liberalising financial markets. Banks and other institutions that have developed in easier, more protected, conditions will have to adjust. But the pace of change should not be so rapid as to undermine financial stability. It has to be recognised, too, that managing change, and at the same time balancing the conflicting claims of powerful vested interests in Japan's financial establishment, presents a particularly delicate challenge for the authorities. Nevertheless, resisting intense pressures for change would not leave Japanese institutions well placed to exploit fully extensive recent innovations in the provision of financial services. Maintaining excessive controls in the domestic market would, given greater international openness, divert yen banking and fund-raising business from Tokyo abroad. The time for steady, carefully-managed, change would now seem particularly ripe. With somewhat higher growth, and substantially improved profitability, fewer companies face financing difficulties and the banks' position is correspondingly healthier. Also, easier monetary conditions reduce the gap between regulated and market-determined interest rates. In such circumstances, the disruptions of increased deregulation would be minimised.

In more liberalised markets, interest rates in Japan will have to become a more powerful channel of transmission of monetary policy. In many OECD countries, dealings in Treasury bills provide the central bank with an efficient mechanism for influencing short-term interest rates since such bills are widely held by private financial institutions at market interest rates. If an effective short-term government debt market develops in Japan, the Bank of Japan's ability to implement monetary policy would be enhanced. The average level of interest rates in the economy need not, however, be higher under a deregulated system. While greater efficiency should narrow the gap between interest rates paid to depositors and those paid by borrowers, the high level of saving should ensure that Japan does not become a high interest economy.

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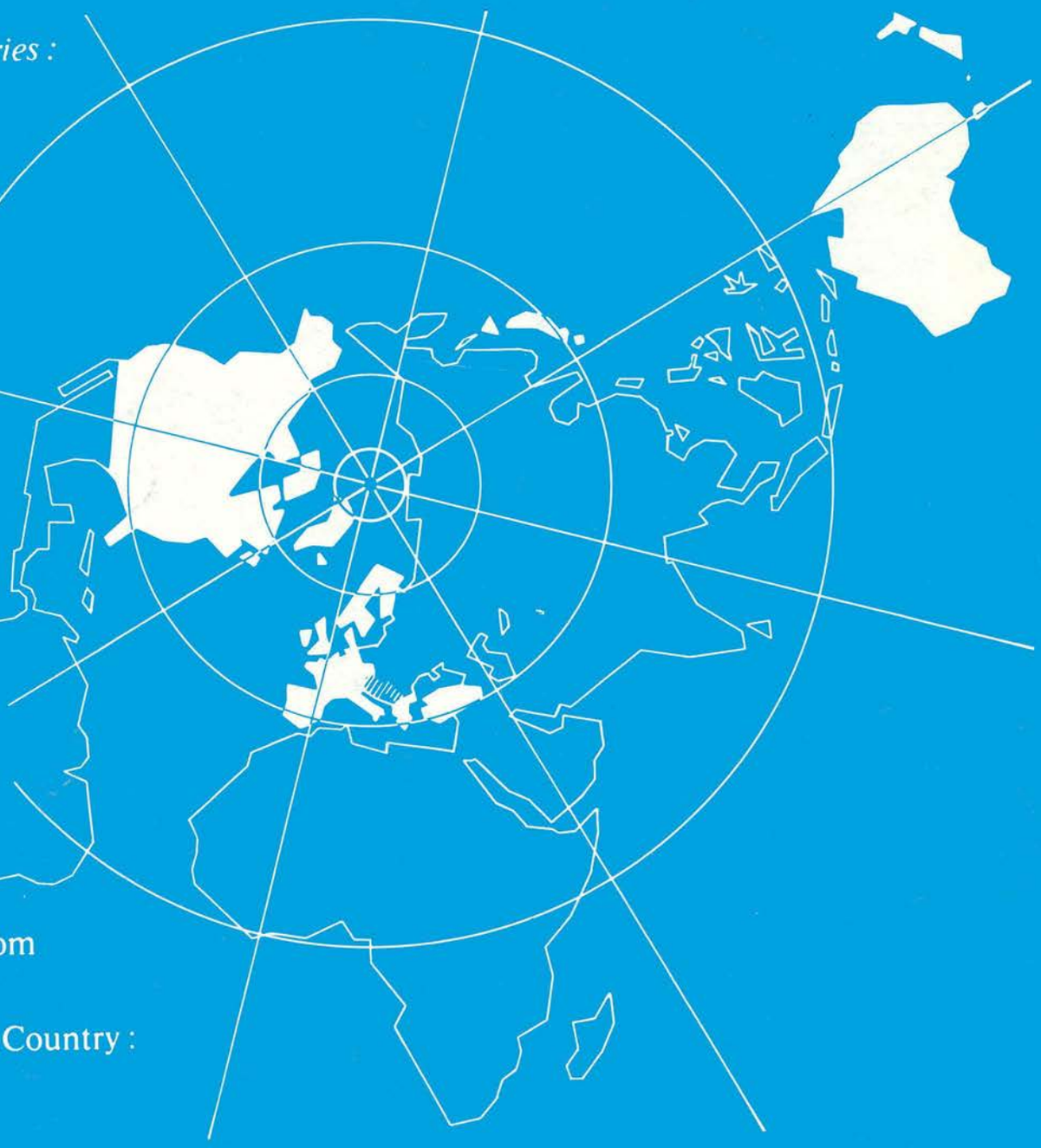

ISSN 0029-7054

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