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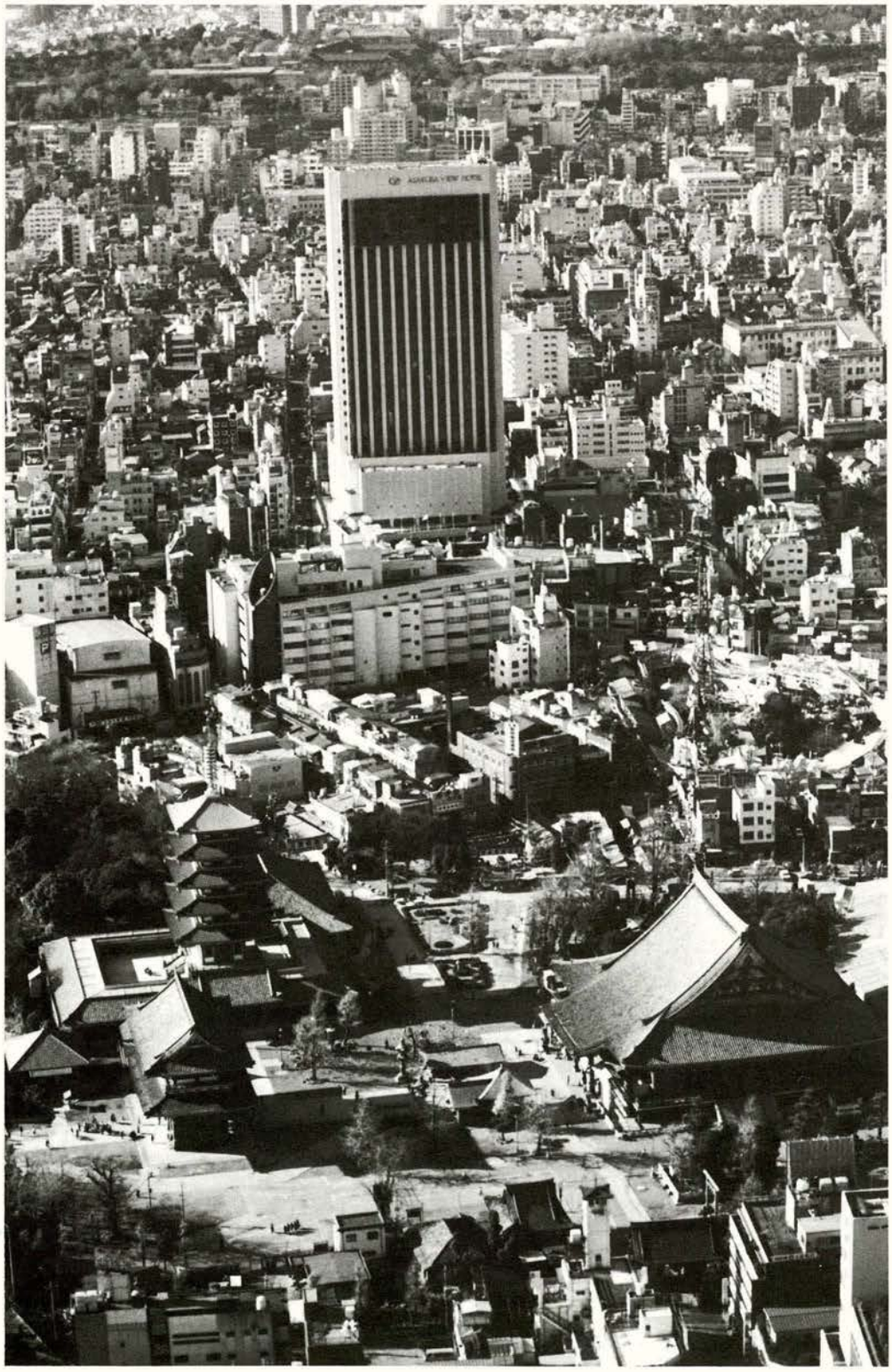
Japan: The Urban Challenge

by John Zetter[1]

National urban policies are framed in terms of two distinct but related aims, both directed towards development. First, they seek to guide the location *of urban development. Second, they try to influence the* character *of urban development and redevelopment. Hence, the essence of urban policies is that they are spatial and targeted. These characteristics make such policies valuable weapons in the policy armoury at a time when some of the major social and economic challenges facing OECD societies are highly concentrated in cities, often in combination. It is for this reason that OECD's Group on Urban Affairs has decided to review national urban policies: the first study focuses on Japan.*[2]



1. *Head of Urban Affairs Division, OECD Environment Directorate.*

2. Urban Policies in Japan, *to be published shortly. The examiners were T. Britton (United States), Chairman of the OECD Group on Urban Affairs, B. Birgersson (Sweden) and D. Stroud (United Kingdom), Vice Chairmen of the OECD Group on Urban Affairs, C. Hemmer (Luxembourg), Chairman of the OECD Project Group on Housing Finance, S Jussil (Sweden), M. Logan (Australia), R. Mabey (United Kingdom), J.-E. Roullier (France), G. Town (New Zealand), S. Trollegaard (Denmark), H. Wollmann (Germany) and H. Yap (Netherlands).*

Japan is among the most highly urbanized countries in the OECD, with almost 65 per cent of its population living in agglomerations of over 50,000. The rate of increase in the urban population in the last 30 years has been the third fastest in OECD. The total increase (52.8 million) has been larger than the *total population* of all but five other OECD *countries*. This combination of recent and rapid urbanization has brought with it the need to incorporate an urban perspective into the formulation of government policy.

Now urban Japan is in a transitional phase. In the coming decades, it will be confronted with the need to cater for continuing urban growth: another 18 million urban residents will have to be housed by the year 2000, roughly two more cities the size of inner Tokyo. But, in addition, there will have to be urban renewal and an improvement in the quality of urban life. The combination of these linked trends of growth and the need for renewal will constitute a major task for Japanese society.

In reviewing policies, it is useful – both in evaluating the success of current policies and suggesting alternatives for the future – to consider their stated objectives. The most comprehensive set of Japanese urban policy objectives is to be found in the national City Planning Act of 1968: balanced development of the country; rational utilization of land; healthy and cultured urban life; and promotion of public welfare.

Balanced Development

In Japan, the process of urban concentration at both national and metropolitan levels has been carried to a high degree compared to other OECD countries with large populations (see table). The first point is illustrated by the close proximity of the three major urban centres (Tokyo, Osaka and Nagoya), the second by the high densities of Japanese cities. To achieve balanced development, broad land-use planning policies are in place as a result of successive national plans. There is a consistent two-fold theme in these national policies: favouring the decentralization of industrial activity, based on the concept of growth poles, and restricting development in the major metropolitan areas.

In practice, economic and market forces, combined with the lack of strong instruments for implementing national plans, have tended to intensify urban concentration in the metropolitan areas of Tokaido (the urbanized south coast of the island of Honshu which includes the three largest cities, Tokyo, Osaka and Nagoya). The 18 "technopolises" (growth poles based on high-tech industries), even if fully implemented, would only cater for a maximum of 1.9 million people by 1990. However, there are signs that the central government may be willing to set an example by decentralizing some of its operations from inner Tokyo.

The second major switch of emphasis, which is already taking place but needs to be accelerated, is the restructuring of the metropolitan areas. Since growth will come mainly from a natural increase and not from rural to urban migration, the accent needs to move from national urban policies, which in any case have not been successful in stopping the unbalanced growth of Tokaido, to seeking balance within the metropolitan areas. A more decentralized metropolitan structure, based on subcentres near Tokyo itself and the growth of medium-sized towns on the fringe of inner Tokyo, should be planned, OECD's report finds. This will need to be supported by investment in amenities and infrastructure in the growing towns outside greater Tokyo to make them attractive alternatives to living in Tokyo itself.

Rational Use of Land

Land in Japan is particularly densely occupied and utilized. Comparative figures for other OECD countries illustrate the high ranking of Japan in terms of the density of both population and economic activity. It is the third most densely populated country after the Netherlands and Belgium and also third in terms of GNP per unit area (see chart). There have been some large-scale land reclamation schemes, such as Port Island in Kobe, but these do not significantly affect the overall land supply situation in comparison to the predicted growth of population and economic activity.

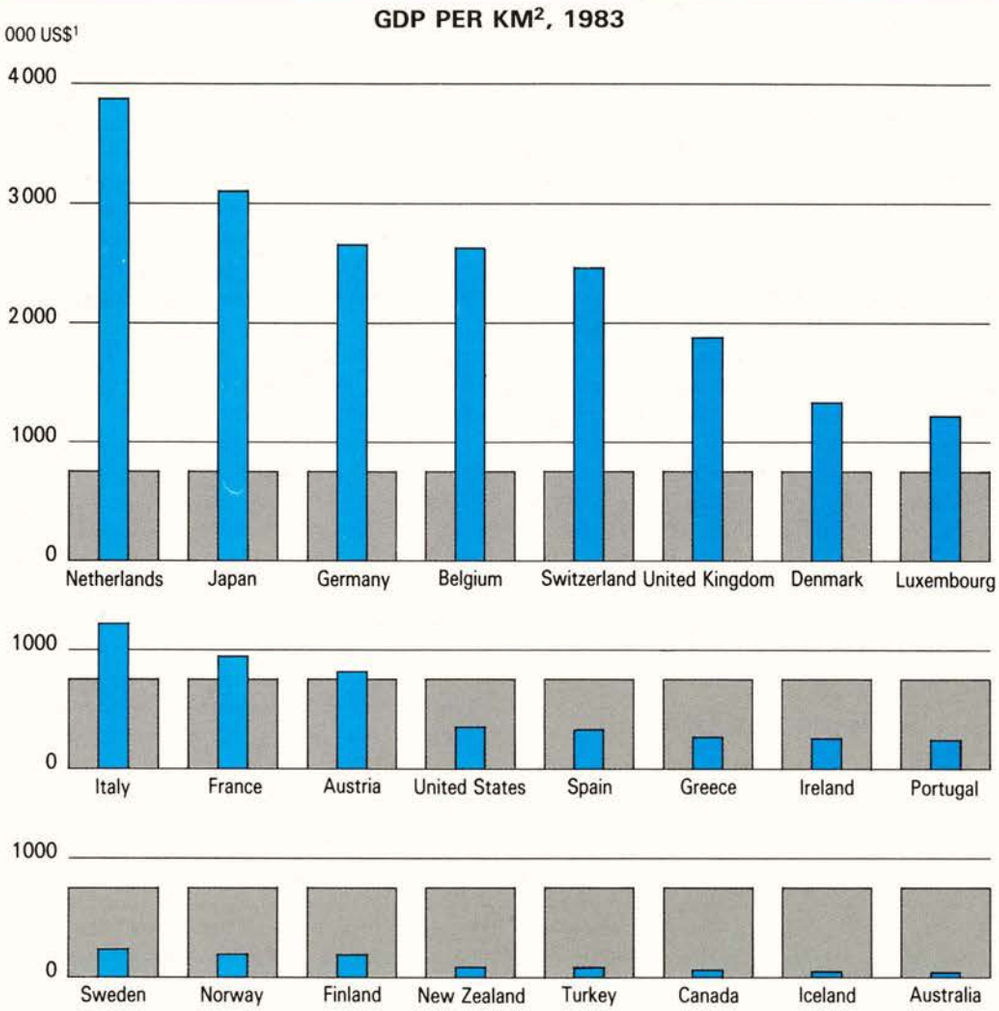
Account also has to be taken of the physical geography of Japan. It is estimated that only a fifth of the Japanese land area is habitable as compared, for example, to two thirds in France and Germany and half in the United States. Certainly, because of the concentration of urban development in Tokaido, general urban densities in Japan far exceed those of other OECD countries. In 1980, for example, 60 million Japanese, over half of the national population, were living in 10,000 km^2 comprising the Densely Inhabited Districts (areas with more than 4,000 people per km^2 and a population of over 5,000). This is an area slightly less than that of the Paris Region which, with

1. CONCENTRATION OF POPULATION IN CITIES, 1980[1]

Country[2]	*Population in Major Urban Areas (thousands)*			*Major Urban Areas' Share of Total Population (%)*		
	Largest	*3 Largest*	*All Cities[3]*	*Largest*	*3 Largest*	*All Cities[3]*
United Kingdom	6 713	11 958	38 932	12.0	21.4	69.8
Australia	2 875	6 396	9 508	19.7	43.9	65.2
Japan	**8 349**	**13 085**	**75 520**	**7.1**	**11.2**	**64.5**
United States	9 120	23 700	139 171	4.0	10.5	61.4
Canada	2 999	7 095	14 591	12.3	29.1	59.9
New Zealand	770	1 381	1 863	24.2	43.5	58.7
Iceland	126	126	126	55.2	55.2	55.2
Spain	3 180	5 686	20 446	8.3	14.9	53.7
Germany	6 052	11 671	32 582	9.8	18.9	52.8
Switzerland	839	1 569	3 243	13.2	24.7	50.9
France	8 510	10 760	27 532	15.7	19.8	50.7
Greece	3 027	3 854	4 807	31.1	39.6	49.4
Netherlands	927	2 273	6 246	6.6	16.1	44.3
Denmark	1 382	1 797	1 942	27.0	35.1	37.9
Italy	2 831	5 569	21 322	5.0	9.8	37.7
Turkey	4 666	8 054	15 414	10.4	18.0	34.5
Ireland	525	662	1 149	15.3	19.2	33.4
Sweden	1 386	2 534	2 737	16.7	30.5	32.9
Austria	1 531	1 973	2 473	20.3	26.1	32.7
Belgium	998	1 460	2 953	10.1	14.8	30.0
Norway	649	959	1 210	15.9	23.4	29.6
Finland	759	1 057	1 307	15.9	22.1	27.3
Luxembourg	80	80	80	21.8	21.8	21.8
Portugal	808	1 299	1 559	8.2	13.2	15.9
TOTAL OECD	**69 101**	**124 998**	**426 710**	**8.9**	**16.0**	**54.7**

1. *Or nearest available year.*
2. *Ranked by percentage share of total population in all cities.*
3. *All urban areas with a population of 50 000 or more.*

Source : *OECD, National Yearbooks and Statistical Yearbooks.*



1. Gross domestic product, at current prices and exchange rates.

Source: OECD, FAO.

Low-rise, high-density housing in traditional style.

approximately 10 million inhabitants (or just over 1,000 per sq. km.), is the most densely populated in France.

Now Japan is facing a period of urban deconcentration. This process, involving both new development and the redevelopment of older areas, needs to be handled in an orderly way. If it is, this can also help to ensure the efficient provision of urban infrastructure and to safeguard land resources, as well as to meet aspirations for an improved standard of urban living and environment.

To achieve an improvement in the land-supply situation, under-used land in the large metropolitan areas should be identified and incentives introduced to bring it into effective urban use. To support these measures, central government should become more actively involved in securing, releasing to the private sector and, more generally, monitoring the supply of land for urban development. Changes in the agricultural support system and in the balance between rural and urban interests will also be needed if the process of metropolitan development is to be handled effectively.

To support these urban planning measures, changes in land and property taxation are also required. The tax on the holding of land allocated for development needs to be progressively increased so as to discourage speculation, particularly in the three major metropolitan areas in Tokaido. The increase in the rate of taxation on holding land needs to be complemented by the reduction of taxes which discourage its sale. A general property tax reflecting the value of land would be a better way to secure the release of land and to stabilize its price than a capital gains tax imposed at the time the land is sold, as is now the case. These changes in taxation would initiate a process of land assembly and make its subsequent progress easier.

Quality of Life

The nature of the urban environmental challenge facing Japan is changing. First, older, polluting heavy industries have been replaced as the country's industrial structure has modified. Secondly, newer industries tend to be located on inland urban sites served by road transport. Thus noise and air pollution, and pollution to inland (as opposed to coastal) waters have emerged as new concerns.

Parallel to these changes, emphasis has shifted to pollution caused by day-to-day activities of the new urban population and the wastes – water and solid – produced. If the polluter pays principle is applied, it is individual households, either directly through user charges or indirectly through taxation, who will need to meet the costs.

Action is being taken at government level to make the public more aware of the importance of maintaining and improving environmental quality in towns. One focus is the present tendency to concentrate on renewal schemes consisting of high-rise flats. Although clearly there is room for some such accommodation, alternative ways of reconciling open space and high-density living must also be found. This is particularly necessary in view of the importance given to the right to sunshine in Japanese cultural values.

Promoting Public Welfare

The stock of urban infrastructure in Japan is relatively small in comparison with the national standards that have been set or in international terms. Furthermore, the growth rate of investment in infrastructure is decreasing at the same time as demand for both infrastructure and services is increasing. There will be a continuing higher than average need for investment in overhead social capital in Japan because of the need for disaster prevention and the low level of existing provision.

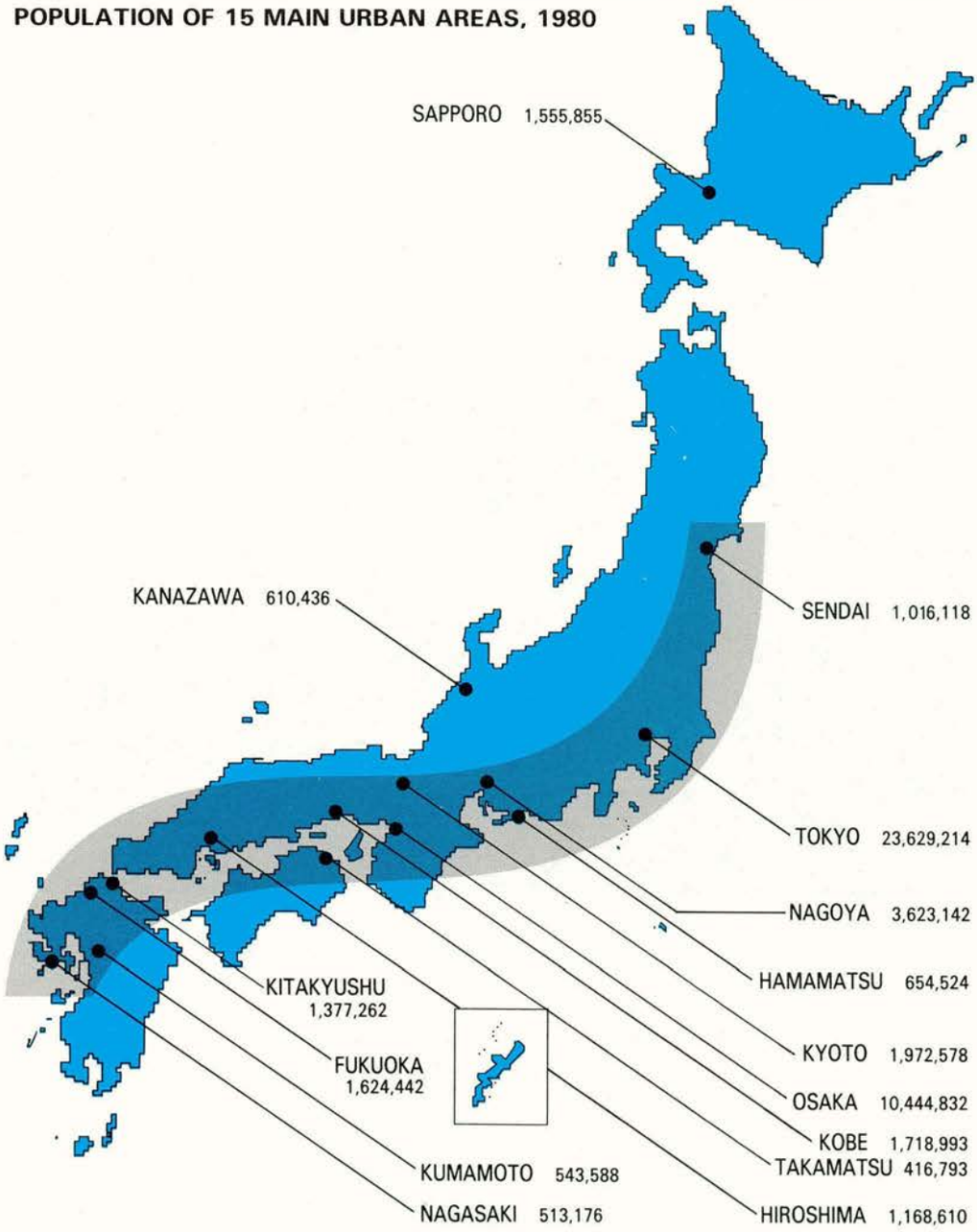
Local government spending is more important in Japan than elsewhere in OECD, but local resources come in large measure from the national government. In a period of fiscal and financial restraint, it is vital to target infrastructure spending to priority areas. One approach by the national government would be to reflect specific urban needs to a greater extent in allocating funds for special purposes (e.g. sewage works) to local government.

However, in view of the failure of past rates of infrastructure investment to keep up with short- and long-term targets, more private resources will be needed. In financing infrastructure and urban services, there should be less emphasis on central government subsidies for providers and users, and more emphasis on charges for use. Another method would be to make the rise in the price of land, caused by the infrastructure, pay for its provision. Also, more use should be made of procedures which provide infrastructure at no public cost, for example having it paid for by the developers of a project.

Housing and Urban Revitalization

The Japanese government is increasingly encouraging renewal of the older, overcrowded, inadequately serviced parts of the larger cities. However, there is a growing appreciation that current programmes are insufficient to match the speed of deterioration of the quality of life in the larger metropolitan areas. One response to this is an interest in increasing the level of private investment in urban development and renewal programmes.

POPULATION OF 15 MAIN URBAN AREAS, 1980



Note: *Japan's total population in 1980 was 117.06 million.*
Source: *Japanese reply to an OECD Urban Information Survey.*

The goals set in the 1981-85 housing programme aimed at ensuring that, by the latter year, no household would live in accommodation below the minimum housing standards. However, the lack of policy priority for and investment in housing have led to a slowdown in housing construction since the goals were set in 1981. In the light of the relatively low housing supply in Japan compared with other OECD countries, much higher priority needs to be devoted to housing in Japan if supply is to be substantially improved. This is true despite the fact that, measured by the relationship between investment in housing and GDP, Japan's performance is good compared to other OECD countries.

To maintain the demand for improved housing, the system of subsidies may need to be further reoriented to assist households during the initial years of purchase. The basis of housing policies should also be further widened to take into account urban environmental improvement and revitalization considerations and to attract self-help resources.

In view of the importance of disaster reduction measures in Japan, a more sustained effort needs to be put into remodelling buildings in older areas and extending treatment for fire resistance. Model schemes of low-rise, high-density housing should be encouraged to test their suitability for Japanese cities. These schemes should give more recognition to the variety and vitality found in the older areas of Japanese cities, with more use of traditional Japanese architectural styles and motifs. →

High-rise, high-density, new-style housing.

Stimulating Domestic Demand

OECD's 1985 Economic Survey of Japan pointed out that one set of measures that would assist in reducing the disequilibrium caused by the Japanese trade surplus and the unbalanced nature of the industrial structure would be to stimulate domestic demand for housing. Changes in land taxation would also be required.

Subsequent programmes of action to expand domestic demand have emphasized the improvement of social capital and the expansion of opportunities for private investment. OECD's review of urban policies provides some detailed specifications.

The overall performance of the Japanese economy is widely known – the "virtuous circle" of a sustainable growth rate combined with low inflation, low interest rates and low unemployment by international standards. Since economic policies interact closely with urban policies, one cannot effectively argue that the overall financial resources are not available, in either the public or private sectors, to considerably improve urban service and environmental and infrastructure standards in Japanese cities.

Whether the Japanese Government chooses to allocate the resources necessary to meet objectives for urban improvement will be a matter of political priority. The link to domestic demand has been referred to and, while the social and environmental reasons for improving the standard of life in cities stand on their own, in the Japanese case there are also sound macro-economic reasons for upgrading infrastructure and amenities. But the political constraints need to be recognized. Electoral boundaries in Japan have not been redrawn quickly enough to reflect the rapid rate of rural to urban migration in recent decades.

To be effective, urban policy needs to be integrated with a range of other policies, for example, industrial and agricultural policies.

*
* *

Two important changes are taking place in the structure of Japanese industry. As in other comparable OECD countries, the service sector is growing, though not at the expense of manufacturing. The primary sector is in decline but still large, and further contraction can be anticipated. The agricultural sector is itself one that has significant interactions with urban development. Urban and agricultural policies share an interest in land resources, especially in and near the large metropolitan areas.

Another important trend, which is gaining momentum, will also affect future urban development. The growth of leisure time, linked to the rapid ageing of the Japanese population, will greatly influence the demands for certain types of urban facilities and services. The trends are likely to lead to more people spending more of their time in or near their homes. This will put an even higher premium on the standards of both housing and the neighbourhood environment, which will need to be reflected in future urban policy priorities.

Urbanization is a process through which societies are transformed and urban areas are, therefore, in a continuous state of flux. However, the built environment tends to change more slowly than economic and social behaviour. Cities once established can be barriers to progress unless emerging needs are taken into account when development and redevelopment takes place. Urban policies, therefore, play a crucial role in the restructuring of the productive capacity and social life of OECD Member countries.

As seed-beds of interchange, creation and innovation, cities both influence and are influenced by the process of technological development. The Japanese case shows that the targeted and spatial nature of urban policies is a vital ingredient of and complement to other national policies for realizing the opportunities and confronting the challenges presented by social and economic change. ■

Managing the Rural Renaissance

The relentless flow of people from rural to urban areas that has taken place since the Industrial Revolution in most OECD countries seems to have come to an end in the most advanced of them. People are now migrating back to the countryside, leaving the "stranded" regions of industrial decline and high unemployment and finding new economic opportunities in the areas traditionally regarded as "peripheral" and "backward"[1]. Rural areas account for 85 per cent of the land in Europe for example and just over half the population.

As well as green fields and rustic villages, rural areas are defined to include towns. At the same time, economic activity in these regions is not based solely on the land or products derived from the land; in a growing number of rural areas, non-agricultural sectors contribute more to the local economy than farming does. This diversification of rural economies is making it increasingly difficult to define rural areas in economic terms.

The steady loss of population in rural areas was a universal and significant demographic feature of all OECD countries until 1970. The fall-off in agricultural employment was a reflection of growing productivity and efficiency in the farming sector, with displaced workers traditionally going to the cities and industrial centres to find alternative employment. Hence the decline in rural populations was associated with the relative fall in the economic contribution of these areas. The infrastructure of rural areas has in many cases not developed as fast as that in the cities, and this in turn has encouraged their economic isolation.

Since 1970, however, the population in many OECD countries has been flowing back into rural regions. In the United States, for instance, inhabitants of what in that country are called "non-metropolitan" areas increased by 8.6 million or 16 per cent, compared with 10 per cent in metropolitan areas; while much of the increase was due to higher birth rates, there was a net migration of at least 3.5 million people into rural areas. A similar trend has been apparent in France since 1975, while in Italy, the rate of emigration from the Mezzogiorno region dropped dramatically between the 1960s and 1970s. In the more industrial European countries like the United Kingdom and Germany, there has been a marked flow of people into regions that were, until recently, primarily agricultural.

Apart from the increasing attractiveness of rural life for those who make the move, new job opportunities are being opened up, both by the creation of small businesses and by the relocation of existing firms to rural areas. These changes are facilitated by improvements in local transport and communications. The fact that there has been surplus labour in industrial centres, where prospects are often poor and jobs scarce, is also an important factor in the migration of populations back to rural communities. (There are exceptions to this new trend, however; in Spain, Portugal and Turkey, for instance, there is still a net outflow of people from rural to urban areas.)

The move back to the countryside is not related to any turnround in farming trends. Agricultural employment has continued to decline, dropping as a proportion of total civilian employment in the OECD area from 21.7 per cent in 1960 to 9.6 per cent in 1982. By then, 15 Member countries had agricultural workforces accounting for less than 10 per cent of the total, while 20 years ago, agricultural employment exceeded 10 per cent in all but four OECD countries. This decline has not forced all farm workers into the cities in search of jobs, however; many have continued their traditional occupations on a less than full-time basis, supplementing their farm incomes with earnings from unrelated activities. In fact, farming is becoming increasingly a part-time occupation, especially in countries like Austria, Germany, Norway, Switzerland and the United States, in each of which at least 40 per cent of farmers derive the greater part of their income from outside agriculture. In Japan, this has been an important phenomenon for a long time.

Not all partially employed farmers have been able to find additional part-time work to supplement their earnings, though, and have been forced to accept a situation of underemployment or "hidden unemployment". This is common in areas with low agricultural productivity: within the European Community, for instance, it is estimated that over 40 per cent of farms cannot support even one full-time worker. Hidden unemployment is particularly rife in Italy, where about 1.5 million farmers are thought to be underemployed, but it is also significant in parts of France, Greece, Portugal and Spain.

Just as output in manufacturing and the services has expanded far more rapidly than agricultural production over the past two decades or more, so rural economies have diversified into these two sectors, and rural employment growth has reflected that shift. But often the industries that have grown up away from the centres of population have been low-skill, labour-intensive ones like textiles, clothing, leather and footwear which have contracted in recent years and substantially reduced their workforces.

Rural employment growth has been strongest in services, which continue to create more jobs than other sectors in most countries. The service jobs created in rural areas differ markedly from those created in urban areas, though. While services in urban areas cater for the requirements of other businesses and thus grease the wheels of local industry, in rural areas, service firms are more likely to be supplying services direct to the consumer as end products. →

1. *These changes and the policies appropriate to them are investigated in a recent OECD report, to be published shortly under the title* Rural Public Management *which summarizes work carried out under the auspices of OECD's Technical Cooperation Committee and the Committee for Agriculture.*

With an improved infrastucture and ample supplies of labour, rural areas now have a greater opportunity to expand and diversify their economies than they have had for a long time. The new situation presents a challenge: to foster and manage this development in such a way that it does not spoil the attractive features of rural environments, that it uses local assets to advantage without detracting from them and that all resources, both human and natural, are used as productively as possible. But whereas in the past, natural resources in general, and the land in particular, were the bedrock of rural economies, further economic development and diversification came mainly from external investment. In future, however rural growth is likely to come from the improved utilization of the internal assets of rural areas and from rural residents themselves.

Approaches to Rural Development

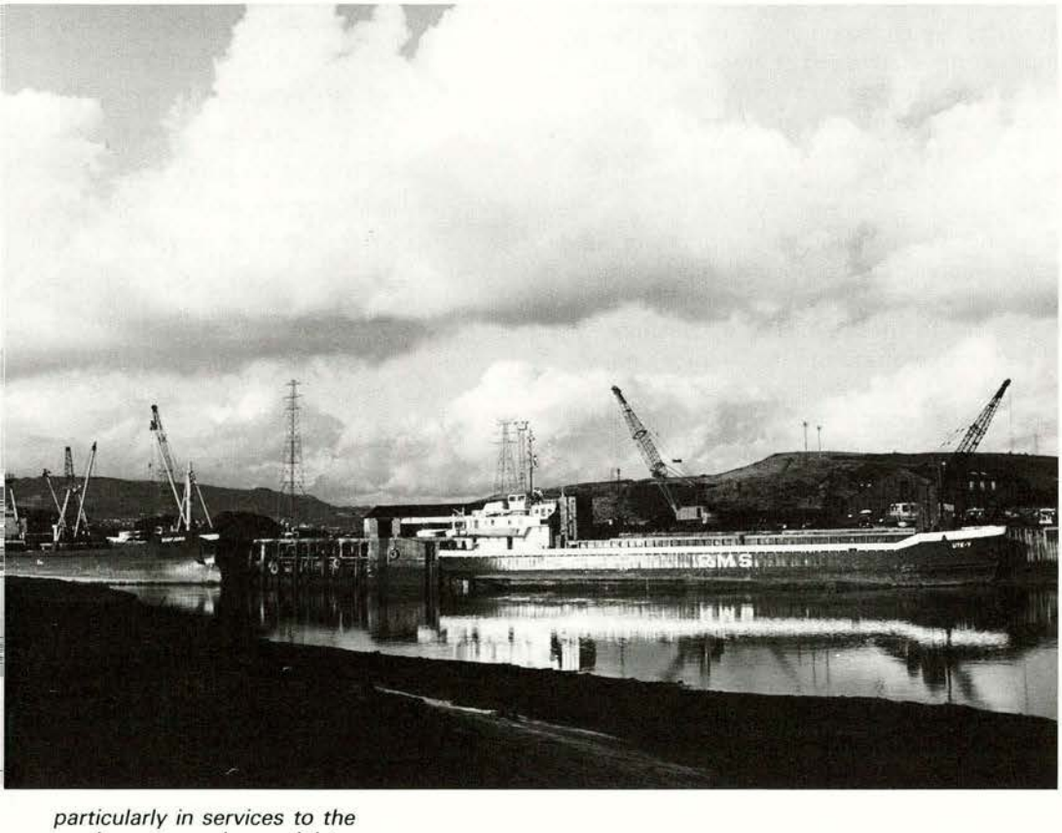
There are indeed many under-used resources in rural areas. These include not only labour, which is often in ample supply and also available at rates of pay that are competitive in both national and international terms. There are other natural resources for which new uses can be found; natural beauty, which has economic potential for recreational purposes and is an added attraction for people who come to work and live in these areas; the cohesiveness and stability of rural society, which can be a source of strength during periods of transition and adaptation; and the imagination and energy of the citizens, which stem from a long tradition of agricultural entrepreneurship.

These assets give rural communities the potential for autonomous economic development and diversification, with the help of external capital, organization or ideas. That leaves rural communities in control of their own development, so that it can be compatible with their native values and lifestyles. To the extent that the indigenous resources of rural areas are under-valued, firms that exploit them successfully will choose to remain there, since their viability depends on continued access to these resources. Hence, "endogenous development", as it is known, may prove more lasting than externally generated growth. And insofar as local firms are locally controlled, their investment decisions and other business strategies are more likely to promote the welfare of the local community.

The future development of rural areas may well depend on the vitality of small and medium-sized enterprises which, despite their high failure rate, still create large numbers of jobs and demonstrate considerable initiative, innovativeness and flexibility in running their businesses. The remoteness of rural areas from the centres of consumption is less of a barrier to development than it once was, while many small firms are well adapted to introducing new process technologies and opening up new market niches for new products. To the extent that new firms setting up in rural areas are technology-based, however, they will need to have suitably skilled labour available locally.

Managing the economic renaissance of rural areas requires an appropriate public sector strategy to both stimulate and control development. In many countries, the renewal of economic activities has been paralleled by, and sometimes contributed to, the decentralization of administrative practices, giving local authorities a greater capability for providing public services and initiating development programmes in their areas. For some central governments, rural development policy is still virtually synonymous with agricultural policy, just as

Some of the reasons why people are moving back to the countryside: Upper left, *the attractiveness of rural life for city dwellers;* upper right, *the availability of jobs,* lower left,



particularly in services to the rural consumer; lower right, *advances in infrastructure have reduced the isolation of these areas. All the above scenes are from Neath in south Wales (UK).*

regional policies are sometimes identical with urban industrial strategies. But such attitudes are outdated.

For many rural areas, the best potential for future economic growth would seem to lie with sectors where entrepreneurs rooted in agriculture switch production to serve markets where there is a demand for products based upon other locally available natural resources. A new approach to rural development policy is needed, one which is designed to take maximum advantage of new opportunities. Complementary approaches to rural development can be distinguished in OECD countries, some that put the main emphasis on developing the physical infrastructure, others based on giving financial backing to the creation and expansion of private business; often a mix of these support policies is developed.

Infrastructure development is primarily aimed at creating conditions conducive to the conduct of commerce and industry and thereby at encouraging their expansion, but it may also have the secondary purpose of stimulating employment temporarily in the construction industry. The main advances made during this century have been in transport and communications, which have reduced the isolation of rural areas and brought them into closer contact with the source of raw materials and with consumer markets. Basic services like water supply, electricity supply and waste disposal have also been improved, while the quality of life in rural areas has been enhanced by improved educational and recreational facilities. All in all, the development of local infrastructures has been aimed at erasing any disincentive there might be for business to develop new plants in rural areas or relocate their offices away from urban centres.

Most OECD countries have combined infrastructure development programmes with schemes for financing the development of business and industry. Funds may be provided to specific sectors (industrial policy) and/or to designated regions (regional policy). In both cases, the range of instruments used is broad, including loans, loan guarantees, equity investment in private firms, grants, and so on. Creating or preserving jobs is often a key objective of these funding schemes, though they may also entail the underlying aim of increasing productivity or financing plant modernization as a means of maintaining the long-term viability of industrial entrerprises. In terms of regional policy, the object may be to promote development in peripheral areas to relieve congested areas, thus yielding an overall improvement in national economic efficiency.

One of the main tasks of local authorities is to overcome the obstacles that still exist for business in rural areas. Sometimes, the sheer distance from decision-making centres (which applies to local government as well as local industry), and from financial centres in particular, remains a problem that local authorities may be unable to do anything about. Sometimes too, because of the centralized nature of the banking and financial services industry, firms in rural areas may suffer from a scarcity of venture capital and other credit facilities. The diffusion of financial/economic information and technological advances may be slower, and that may be exacerbated by lack of a local economic infrastructure or business community.

Servicing the Entrepreneur

One of the most important services that the public sector can render to private enterprises in rural areas is to provide financial assistance or facilitate access to sources of capital and loan finance. Such support can enable firms to finance developments that would otherwise be beyond their means. But traditional funding policies

are often ill-adapted to the needs of rural areas:

- They are frequently only applicable to manufacturing industry, which can furnish collateral in the form of plant and equipment. Service firms may be ineligible for that reason, despite their importance in providing services to industry.
- Regional assistance is often indiscriminate and inappropriate to small regions and local situations. It is often designed to stimulate investment from outside the region and may take no account of local development policies and needs.
- Public financing agencies often shy away from risk. Even in countries which have decentralized many administrative tasks, the control of funds for development often remains with central government, which tends to favour big projects that carry less risk since they are undertaken by established companies.
- Public support for research and development is often limited to only 50 per cent of the outlays needed to bring a product to market. For small firms, however, it may be crippling to have to find the rest of the funds needed themselves. Hence, small firms may be totally unable to invest in new high-technology products and processes.

The problem is basically the availability of capital, not its cost, which is a secondary concern for an innovative firm with high growth potential. Some small entrepreneurs prefer to be self financing to retain their independence, but that is often not possible where substantial research and development effort is necessary. Financial support programmes have to respond to two principal problems, therefore: the short supply of venture capital and the need for financing at all stages of the growth process (especially where the risk is too great for regular banking institutions to participate).

One way of improving the general business climate in rural areas is to create a comprehensive service industry, which has the added attraction of being a dynamic economic activity in its own right, with positive employment effects. Service firms can provide a real network of support for each other, and they prosper by improving the profitability of their customers. By creating an environment in which industrial concerns can flourish, they attract new firms into the locality and ensure their own prosperity.

Many rural areas lack this kind of network, and local companies have to obtain the services they need from urban centres that may well be far away. More likely, rural firms will simply make do without these services. But they would certainly benefit from the presence of firms to conduct feasibility studies, provide managerial skills and advice, facilitate technology transfer and absorption, and supply all manner of marketing and sales data and information about competing products and companies. Most of these services can be provided by the private sector, but their failure to emerge spontaneously suggests that there is a public-sector role for encouraging their development.

Policies for Rural Development

Rural development policies have to be concerned not only with the economic side of life but also with the general welfare of rural citizens. As such, they concern a large number of government departments as well as local authorities. Better policies can only come from an improvement in the organization and management of the policy-making system. In particular, government policy relating to rural areas needs to be coordinated at both the formulation and implementation levels. This requires decision-making structures and procedures that meet three basic requirements:

1. The early recognition of problems through the monitoring of emerging trends as well as the continual evaluation of the impact of current policies on rural areas.
2. More complete and accurate information to provide a basis for policy formulation.
3. The commitment and support of all parties concerned to ensure that policies are fair and coherent and that the responses to these policies are positive.

A basic prerequisite for implementing positive rural development policies therefore is the recognition by competent local institutions that rural development addresses a series of cross-sectoral issues for which no remedies can be found through a narrow sectoral approach. These institutions should not seek to act alone but must consult with, and obtain the cooperation of, all the actors involved. They may have to have independent revenue-raising powers to finance their initiatives, and they will certainly require an adequate level of managerial and decision-making capability (founded on an effective administrative organization with well-trained staffs).

The real challenge to rural communities, however, is not simply to carry out routine functions efficiently but rather to find innovative responses to current problems and events and facilitate the transition and adaptation of their economic and social structures. For that, they require not only sufficient funds and an appropriate institutional framework, but also highly competent and imaginative managers to take charge of their affairs. The OECD is continuing to study alternative ways of improving the processes for formulating and implementing effective policies for rural development. ■

Labour Flexi
A Controve

With prevailing high levels of unemployment and a clear need for structural adjustment, evidence of undesirable rigidities in labour markets is building up. Easing these rigidities could help economic growth and job creation. On the advice of OECD's Manpower and Social Affairs Committee, the Organisation's Secretary General set up a high-level expert group to advise on how flexibility in labour markets could be enhanced. Leadership of this group was entrusted to Professor Ralf Dahrendorf of the University of Konstanz in Germany, a former Member of the European Commission as well as a distinguished sociologist[1]. The report is a unanimously agreed document on what is, in many countries, a highly controversial issue[2].

Market
bility:
rsial Issue

In OECD countries today, the need for greater flexibility, including labour market flexibility, is widely recognized, as is the necessity of greater overall capacity for social and economic change, involving institutions as well as individuals, employers as well as workers.

Unemployment, which has trebled since the early 1970s, must be combatted, but the group found that it could not confine itself to this aim; it had to be concerned with the balance between economic efficiency and social progress as well. Labour market flexibility, it considered, is not a panacea for all social and economic ills nor is it even the most important factor affecting this progress. But it is one of them.

The report takes the now widely accepted view that structural change is necessary to get back to a more normal growth path. In this context "structural" implies changes in attitudes and institutions which are not necessarily part of traditional economic policy: the spirit of enterprise is included, as are adequate spending on research and development and an international trade and monetary system that is open for new actors. Labour market flexibility is seen within this set of structural policies.

A World of Differences

In considering the question of labour markets, the authors directed their attention to differences between countries. As an indication:

- In the United States, there is a tradition of geographical (and perhaps social) mobility which stems back to pioneer days and has no equivalent in most other OECD countries.
- In Japan, post-war conditions gave rise to a practice in which large firms offer their core labour force strong employment protection while expecting it to remain internally mobile to an extent that is unknown elsewhere.
- In Germany, trade unions organized on an industrial basis, coupled with institutions of co-determination (and other historical factors) have led to moderate wage demands; the absence of these factors in countries like the United Kingdom has had the reverse effect.
- In France, the role of government in industrial relations is considered by the group to be a direct result of the relative weakness of both employee and employer organizations, and this may have deep historical roots.
- In a number of smaller European countries, an implicit or explicit consensus between unions, employers and government has helped prevent the kinds of friction that have elsewhere contributed to the rapid rise in unemployment.

These differences are not fixed and may evolve with structural change itself, but they show that no one package of measures can serve all countries equally well. "Cultural uniqueness is also a source of strength", says the report and more than one route can lead to the four goals set forth by the authors – effective adjustments, continuous innovation, higher employment and a better quality of life.

What Affects Labour Flexibility?

Six factors are identified:

1. *Labour Costs*

This is the most contentious issue. "Historically, there can be little doubt that rapidly rising labour cost is related to the emergence of labour-market imbalances, including unemployment", notes the report. But the statement is qualified. "While rises in unemployment between the two oil shocks can to a considerable extent be accounted for by increases in labour costs, other factors, such as sluggish demand growth and high real interest rates, must be adduced to explain developments since 1980." Citing current economic literature, the report suggests that a 1 per cent fall in real wages would result, in the long term, in an increase in employment of 0.2 to 0.5 per cent or more, in theory at least. In practice, wages (and non-wage labour costs) are "sticky". Moreover, it is undesirable, for reasons of equity as well as demand creation, to allow major downward fluctuations of labour costs. Thus the report concludes "control of labour costs, and notably wage moderation, is of critical importance" for the goals identified. "Wherever real wages are allowed to grow above productivity increases, broadly speaking, additional unemployment will follow. However, such wage moderation does not mean that real wages must remain static and not rise over time".

Wage differentials may be less rigid than wage levels, and can provide an incentive for structural change affecting regions, industries, skills, and age groups. Regional differentials for example affect mobility. As to skill differentials, especially in European countries, if reduced too much, they will encourage a process of "deskilling" which is detrimental both to economic adjustment and to technological change. The evidence about wage rigidity for young people suggests that it is at least partly responsible for youth unemployment in some countries.

Statutory *non-wage labour costs,* such as social security contributions, are clearly an important source of revenue for social policy but may weigh heavily on labour-intensive enterprises, and notably on small businesses. Where such costs are high and rising sharply, the Dahrendorf group suggests that there is a good case for reducing them, but the social costs may have to be financed by an alternative tax and/or cuts in public expenditure. In this context, the fall in oil prices means that a tax on oil might be used in some countries to cut payroll taxes on labour.

2. *Conditions of Employment*

Job security is very important, and may be traded off against wages as is the case for some widely publicized agreements in the United States and in Belgium, France and Italy, where limitations on wage indexing have been accepted. Yet, job security also introduces an element of rigidity into labour markets and imposes a cost on employers and hence may contribute to reducing employment, inhibit speedy adjustment to changes in market conditions, or be used to encourage part-time employment or growth of the unprotected sector. But of the countries which do reasonably well in employment terms, some are highly regulated (e.g. Sweden and Austria), others highly unregulated (e.g. the United States and Japan). The practical question is how one can strike a balance between desirable job security and necessary labour market flexibility. In this context, increasing employment levels would help generate confidence that flexibility is desirable.

Employment protection measures introduced after the first oil shock had to be corrected when it became clear that job

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1. The other Members of the high-level group were: Martine Aubry, Director of Labour-Management Relations, French Ministry of Labour; Douglas Fraser, Professor of Labour Studies, Wayne State University and former President of the United Automobile Workers of America; Joseph Isaac, Deputy President of the Australian Conciliation and Arbitration Commission; Lennart Johansson, Chairman of AB SKF, and President of the Federation of Swedish Industries; Yotaro Kobayashi, President of Fuji Xerox Co. Ltd., Japan; Harold O'Sullivan, Executive Chairman of the Health Services Development Corporation, and a former General Secretary of the Local Government and Public Services Union, Ireland. Members of the Group served in their personal capacity and the views expressed do not commit any organization with which they are concerned.

2. Labour Market Flexibility, *OECD, 1986.*

Left-hand page: *In the United States there is a tradition of geographical mobility, going back to pioneer days, which has no equivalent in most other countries.* Right-hand page: *In Japan, by contrast, there is relatively little mobility from firm to firm but a great amount of movement from job to job within a firm.*

security legislation had itself become part of the structural problem, and thus a new balance between security and flexibility may be emerging.

At least as important may be new types of labour contract, notably part-time employment, which has increased more rapidly in most OECD countries in the 1980s than in the latter part of the 1970s. This development is regarded by the Dahrendorf group as "largely desirable" since it meets both the needs of the labour market and the wishes of new entrants to this market, especially women. Part-time contracts can, however, be abused, and this suggests the need for a surveillance system. If part-time work is involuntary, it is but another facet of underemployment.

In at least one country, Germany, legislation has made limited-term employment of up to 18 months possible without application of general dismissal procedures. There is a thin line here between flexibility and the growth of the unprotected sector of the labour force.

Coexistence of a core of securely employed people with a periphery of more mobile employees has always occurred and is not always undesirable, in the Dahrendorf group's view. There is no reason why conditions of work should be worse for those who are not permanently employed, than for those who are. Nor should it be assumed that there is no movement of labour from the periphery to the solid core. However, trade unions have been concerned with the core-periphery distinction on both economic and social grounds[3]. Clearly, the key to equity in this respect is the extent to which it is possible to match the employment aspirations of individuals and the needs of enterprises.

3. *Work Practices and Patterns*

The organization of work needs to be modified, especially when technological change is introduced, so as to enrich work content and raise levels of skill. This would lead to both productivity gains and greater occupational mobility on the part of workers.

New working time arrangements are a topic of debate, especially in Europe, but the report comes out strongly in favour of them. The secular reduction in lifetime hours of work has been accompanied, almost everywhere, by what the report considers to be remarkably rigid arrangements for entry into the labour market, and also for weekly working hours, holidays, and retirement. These prevent enteprises from using their capacity fully, especially when there are technological changes. They also make seasonal and conjunctural adjustments more difficult, lead to underemployment and deter additional employment; and they do not necessarily reflect the wishes of many individuals.

There are now signs that the long-term trend towards lowering the number of hours worked over a lifetime has come to a halt. A further reduction of working time, including constraints on overtime and provision for early retirement, are seen favourably by the group as short-term solutions. But, in the medium term, there may also have to be reductions of total hours worked. But, to prevent unit labour cost from rising, new work schedules will be required. Lowering hours overall while at the same time encouraging flexible distribution of remaining hours locally, as suggested in recent French legislation, is considered an impressive attempt to solve this problem and judged to be acceptable as a way of reconciling better capacity utilization and greater control by individuals over their time.

For limited, but important, groups of people, technological changes make it possible to work at home, using computers or other equipment. Though there are practical as well as social reasons why such arrangements cannot be generalized, they too provide opportunities for reconciling individual and economic needs.

Such new kinds of work contract may mean that members of a family are free at widely varying times, for example. But such problems are likely to lose importance as flexibility becomes the rule rather than the exception.

4. *Rules and Regulations*

A number of rules and regulations which, while not directly related to employment, nevertheless have an effect on the labour market and its flexibility. Like non-tariff barriers in trade, they tend to proliferate, and often take the place of more traditional obstacles to free movement. Certain environmental regulations are mentioned as are workers' tax levels and progression. The third, concerning small businesses, probably has the most scope for action in this regard.

Small and medium-sized firms (less than 500 workers), which employ between a half and two thirds of all people in OECD countries, especially in the service sector, and which may be highly innovative, may face obstacles such as unduly high non-

3. *See the introduction to the paper by the British TUC:* Flexibility: A Trade Union Response. *TUC, London, December 1985.*

wage labour costs, strict rules to protect employment and administrative barriers which prevent such companies from setting up or interfere with their functioning. "A climate which is favourable for new ventures has contributed to some of the desirable trends on the United States labour market", the report adds.[4]

5. *Mobility*

All forms of mobility contribute to labour market flexibility. The apparent decline in both geographic and job mobility since the early 1970s may be a sign of increasing rigidity and leads the group again to emphasize the need for macro-economic policies to stimulate growth.

The various kinds of mobility may be substitutable, one for the other. Mobility within a firm, for example, may offset a lack of external mobility and vice versa. The contrast between high internal and low external mobility in Japan may have a similar combined effect on the Japanese labour market as high external and low internal mobility in the United States.

Since mobility depends on macro-economic pulls and pushes, employment opportunities, income differentials and other forces, it is almost synonymous with flexibility.

Geographical mobility is effective but costly. Yet growing immobility and increasing regional differentiation suggest to the group a need for action: greater transferability of pensions, the opening-up of housing markets, the abolition of counter-productive subsidies and training young people so that they consider it natural to move.

As to *external* mobility (from firm to firm), high labour turnover may signify opportunities for individuals, but it also involves costs to the firm, apart from being an index of morale problems. Occupational mobility, the report suggests, is particularly important and needs to be strengthened through incentives ranging from income differentials to training opportunities, even if the quantifiable effect of such measures is limited.

Internal mobility or functional flexibility is only possible if the firms involved are large enough and employees are prepared to change job or even occupation. There are obstacles to such movement, particularly in Europe, including demarcation practices, a lack of retraining facilities and fear of change. In Japan, such flexibility is widespread in large firms while in the United States it is, as noted, compensated for by external mobility.

6. *Education and Training*

The group views education and training as keys to a more flexible workforce since, among other things, they affect attitudes and contribute to occupational mobility.

The report repeats some common OECD themes such as the need to concentrate on basic knowledge and skills, to prepare students for vocational change, lifelong retraining and learning, and education for leisure.

Implementing Change

The possible agents of change in this area are multiple, but it is government action and collective bargaining that hold the keys to this matter of flexibility. Government action is relevant not only in areas in which the government is constitutionally responsible, such as legislation on health and safety or public education, but also in industrial relations more generally. However, the report concludes that the scope for further action by governments in matters relevant to labour market flexibility is limited. Trade union membership in many countries is stagnant or declining and, the report says, unions often focus on the defence of past achievements rather than demands for improvement; there are fewer strikes almost everywhere. At the same time, many decisions have come to be taken at the level of the individual enterprise, sometimes by unilateral action, but more usually by consultation and negotiation.

Free societies have evolved a variety of methods to reach decisions on the determination of wages and conditions of employment. Most rely largely on collective bargaining. A few put greater emphasis on lawful processes of conciliation and arbitration. But all recognize the importance of autonomous organizations of workers and employers. Strong unions and strong employers' organizations are therefore considered by the group to be one condition for reaching the decisions that are in the interest of all.

Labour market flexibility raises sensitive issues, the report concludes. These touch not only people's sense of security, even of identity, but also the very survival of enterprises and the livelihood of those who work in them. At least on the face of it, conflict between individual interests and economic needs is an inevitable concomitant of any attempts to increase labour market flexibility. This means in the first instance that precedence should be given to aspects of flexibility which promise a balance of advantage. It also means that there is a great and continuing need for consultation and negotiation between those who propose to introduce change and those who are affected by it. Labour market flexibility must not become a weapon used by one group against another. If that happens, strife will ensue, and progress will not take place. What is needed is a "social compact" by all concerned to seek ways which advance both economic efficiency and social progress.

* * *

No standard set of measures will serve all countries equally well. Each country will need to establish its own viable balance of measures and degree of flexibility as well as its particular method of implementing change, to fit in with its cultural and institutional environment. Labour market flexibility is not the only nor the most important element in achieving economic and social progress. Such progress rests heavily on appropriate macro-economic measures designed to maintain a high level of economic activity since labour markets function better as the level of economic activity increases. Moreover, the conflict between the desire for security and the need for change is likely to be more readily resolved in the context of a growing economy. Accordingly, the case for greater labour market flexibility advocated by the group is more likely to succeed if measures are taken on an international scale to overcome the current sluggish demand growth and high real interest rates.

Thus the report concludes there are at least three reasons why the flexibility of labour markets has a strategic role to play in the search for economic efficiency and social progress. One is that it provides a link between specific economic and wider social issues, including social flexibility. Attitudes are involved which have much to do with the dynamism of economies and societies. It should be clear that, to draw the maximum advantage from labour market flexibility, employers and managers must show a sense of adventure and imaginative change as well as responsibility.

Another strategic aspect of flexibility is that security of employment is needed as well as innovation. Both are individual aspirations as well as collective requirements. Like economies, and societies more generally, individuals want to have reliable perspectives of life but avoid stagnation. The issues of labour market flexibility suggest a balance between security and innovation, or rather, several possible balances. A third strategic implication of labour market flexibility: economic policy, like policy generally, has to respond to immediate problems and seek solutions in the short term. However, some of the problems of contemporary economies are not short term, but structural and medium term. Again, labour market flexibility provides a link. There are measures which can be introduced soon, though their effect is likely to take some time. All countries seem to have a long way to go in this respect. The steps to be taken differ, but the need is general. Dynamic economies bent on sustainable growth will have to be flexible. Labour market flexibility is one of the conditions for success. ■

4. *For a detailed analysis from which this is quoted, see* Employment Outlook, *OECD, Paris, 1985.*

Priority for Educational Equality

by David Istance and Jillian Chapman[1]

If women are to have work equality in terms of jobs and salaries and status more generally, they must also have equality of educational opportunity. As the International Decade for Women drew to a close in 1985, OECD examined to what extent progress has been made since the early 1970s. The following article highlights some of the findings of the OECD report[2]*, with examples drawn mostly from upper-secondary, further and higher education, the main areas covered by national statistics. The international comparisons show a clear record of progress. But stubborn inequalities persist and, indeed, new ones have emerged.*

Signs of Progress

Advances in Secondary Education

In general, fewer girls than boys now leave school with no formal certificate (in the United Kingdom and Germany, for example, about 6 out of 10 such leavers are boys). Moreover, in almost all countries, young women comprise half or even more of the students who continue their studies after the minimum school-leaving age in upper-secondary education, especially in the general academic stream. This is most marked in France and the Scandinavian countries, where the most recent figures put the female share of general

1. *Respectively administrator and trainee in the Education Division, OECD Social Affairs, Manpower and Education Directorate.*

2. Girls and Women in Education: A Cross-National Study of Sex Differences in Upbringing in Schools and Colleges, *to be published shortly. The report presents approximately 100 tables of national statistics detailing the balance of the sexes in schools, colleges, and universities, and the changes that have occurred in recent years. To complement this descriptive picture, it includes reviews of the literature, mainly of North American and British origin, clarifying the explanatory factors behind the figures: one review examines sex differences in socialization and upbringing from the earliest years, the other focuses more closely on the school and compares alternative explanatory "models" of differences in attitudes and educational performance among school-age girls and boys. These reviews were written by Constantina Safilios-Rothschild (New York) and Judith Whyte (Manchester).*

courses at 63 per cent in Sweden, 61 per cent in Finland and France, 58 per cent in Denmark, and 56 per cent in Norway.

In part, the high profile of young women in general academic education reflects boys' preference for other types of further education where there may be a better chance to acquire qualifications valued in today's depressed youth labour market – mathematics, science and other technical fields. But the importance of acquiring general upper-secondary diplomas should not be underestimated. They are useful for many jobs, particularly in the services, and continue to provide the principal passport to universities and other institutions of higher education.

It is also true that the overall increase in female enrolments has brought with it a growth, throughout schooling, in the numbers of girls studying mathematics and sciences – traditional "male" subjects – even if the progress can usually be described as little more than modest. Taking two examples, again from upper-secondary education, about half of the young women in the Gymnasium in Denmark are now in mathematics classes, compared with only a third in 1970; and in the United Kingdom, the proportion of girls studying for "A" levels in purely non-scientific courses fell from 64 per cent in the mid-1970s to 53 per cent in 1984.

But these examples must be qualified as at best limited from the standpoint of achieving greater equality. The proportion of boys in the United Kingdom studying only arts and humanities courses at "A" level also fell, signifying the growing attractiveness of the sciences rather than a significant redistribution between the sexes. And the proportion of male students in the alternative to the upper-secondary mathematics line in Denmark – languages – had slumped to a mere 16 per cent by 1983.

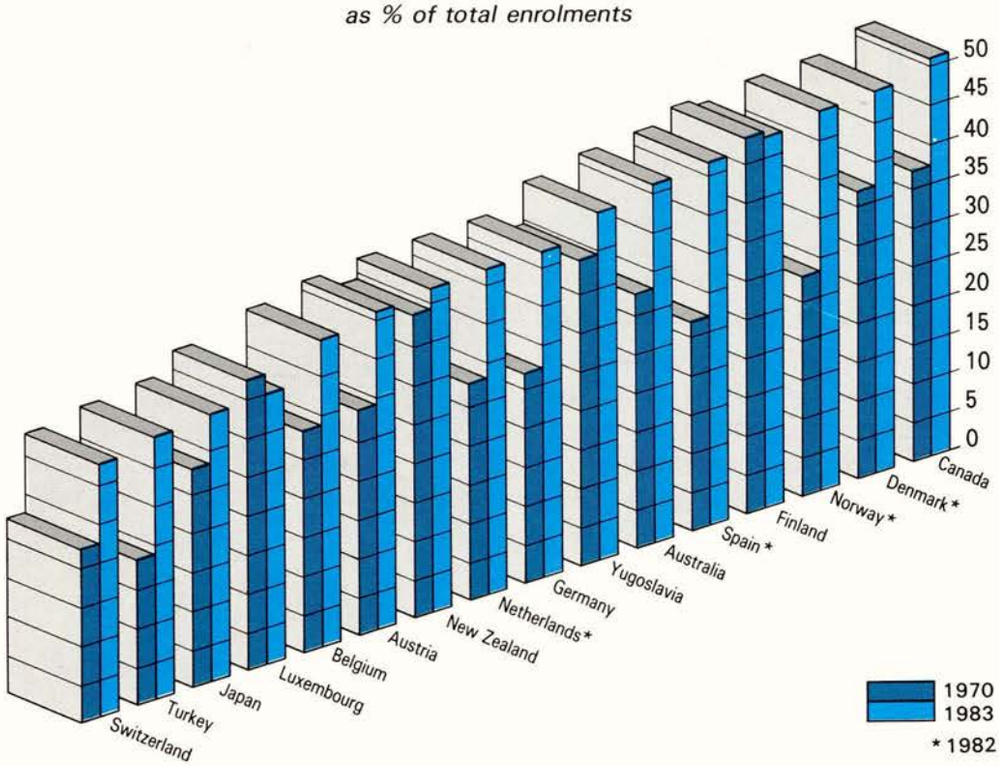
More Women in Further and Higher Education

The growth in the numbers of women studying in *higher education* is one of the most noticeable trends in education of the 1970s and 1980s in OECD countries. Chart A shows the impact this growth has had upon the sex composition of the student body in the countries for which consistent data are available. We are now much closer to numerical equality between men and women in *colleges and universities,* and in Canada, Finland, France and the United States, women comprise half or more of university undergraduate students. Elsewhere the share is commonly between 40 and 50 per cent.

In some cases, however, the doors of first degree university programmes have not been opened to women. The female undergraduate is still in a clear minority most notably in Japan, the Netherlands and Turkey.

Summarizing developments for *further education outside the university* is more difficult, given the wide range of courses and establishments covered by this sector. And the balance of women among these students appears to be equally varied. For example, in Austria, Belgium, Denmark, Germany, Japan, New Zealand, Portugal, and the United States, women predominate as national statistics in OECD's report show. In other countries the opposite is true: less than a third of non-university students in higher education are women in Luxembourg, Switzerland, Turkey, and the United Kingdom.

A. WOMEN IN HIGHER EDUCATION
as % of total enrolments



Source: *OECD Education Data Bank. Countries for which only national statistics are available are not included.*

Female Entry into Male Disciplines

Some of the most interesting changes that have occurred in higher education are in disciplines that do not belong clearly to either men or women. In many OECD countries, for instance, women are as well represented among students in medical studies as they are in the university student body as a whole. In one or two countries – notably Finland and Yugoslavia – these faculties have become, if anything, "feminine" ones, with women comprising 57 and 59 per cent of medical students respectively.

However, medicine, prestigious though it may be, is atypical since it has feminine associations, such as nurturing. In other more traditionally male-dominated disciplines – law, architecture and, in some countries, business management, commerce, and administration – women have made significant inroads in recent years.

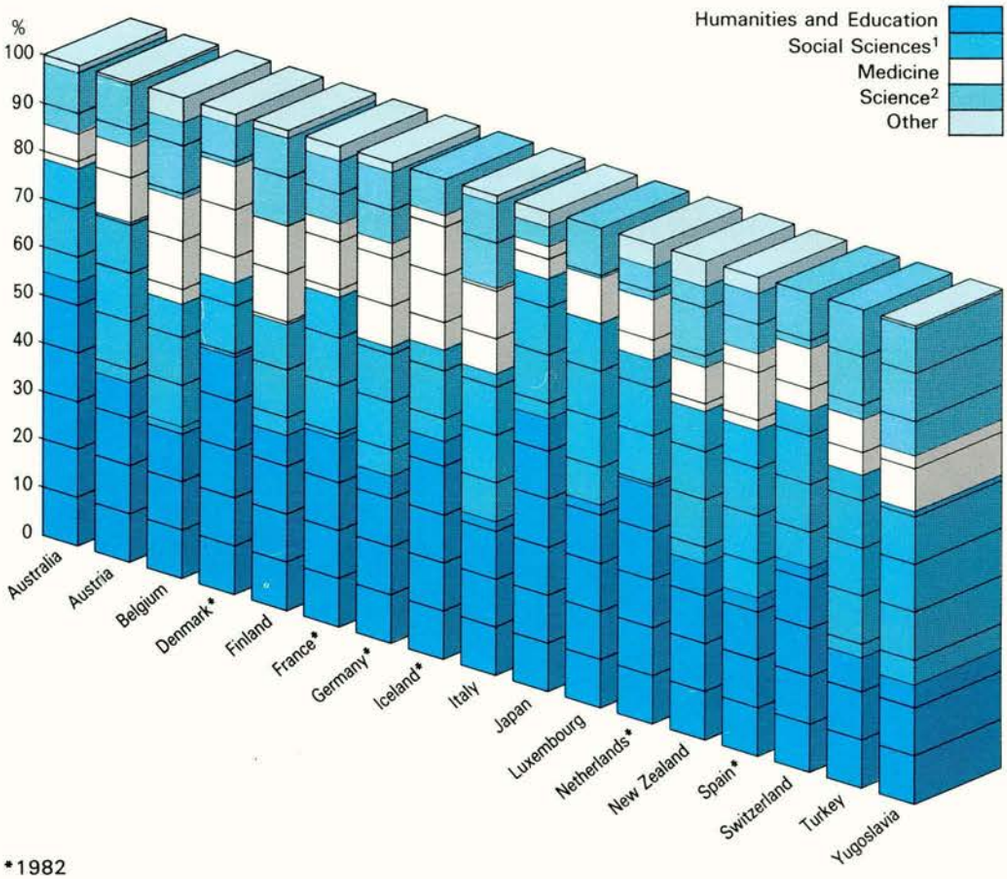
As to the most solidly male bastions – engineering and the applied sciences – there is some evidence of progress. In Canada and the United States, change, albeit very partial, has occurred. A mere 1.5 per cent of successful Canadian bachelor candidates in engineering were women at the beginning of the 1970s. By 1982, the share had grown to 9.1 per cent. This represents approximately an eleven fold increase in actual numbers. The growth is still more dramatic in the United States – over nineteen fold. Nevertheless, only one engineering student in ten is a woman in these countries, and the proportion is still lower in many others.

A substantial body of public opinion holds the view that educational inequalities in such fields reflect natural, biological differences that, by implication, cannot be changed. Yet educational patterns have modified significantly over time and differ from country to country. Hence there is a strong reason to strive for change.

Disadvantages Remain

Despite the advances so far made, OECD'S report finds little reason for complacency. Educational equality between

B. SUBJECTS STUDIED BY WOMEN IN HIGHER EDUCATION: 1983



*1982

1. *Includes law, commercial and business administration, behavioural sciences.*
2. *Includes natural sciences, mathematics, computer engineering, architecture and town planning.*

the sexes is still far from having been realized. Fewer girls attain the highest levels – for instance the top scholarships, or postgraduate degrees. Classes remain sharply divided by sex; in some, a boy is a rarity and vice versa. In many instances, moreover, female predominance in subjects where girls and women are already over-subscribed is even greater now than in the early Seventies. To make matters worse, the feminized faculties are those where subsequent job opportunities have been badly affected by labour-market recession.

The Rigid Division of Female and Male Subjects

Even though some attenuation of the divide has occurred in recent years, choices in secondary school still tend to follow the traditional pattern (girls in the humanities and languages, with boys preferring the sciences). The sharpness of the male/female divide is most clear in the applied subjects: metal-work, woodwork and technical studies are almost exclusively for boys; domestic science is universally a "girls' subject".

Certain "female" courses have actually become more dominated by girls. To take a single example, one of the most popular of the upper-secondary *baccalaureat* programmes in France is humanities (*baccalaureat* "A") where some 72 per cent of the successful candidates were women in 1972. Their dominance of this humanities diploma had risen further by 1983 – four successful candidates out of every five were young women. During the same period, girls accounted for scarcely more than a third of the valued *baccalaureat* "C" passes (mathematics and physical sciences), and this balance has not improved since the mid-1970s.

The rigid gender divisions are, if anything, more striking in the vocationally oriented fields, rendering still more imposing the task of eliminating employment and occupational segregation. One way to show this is to take the ratios of males to females in different vocational subjects and to compare the number of options in which male-female ratios lie within the 40-60 per cent range with those where the balance of the sexes is more skewed. Not all countries have statistics allowing such comparisons, and thus any examples are merely illustrative. In Switzerland, for example, only two out of twelve programmes enjoyed a balance within this range in upper secondary vocational education in 1983. The equivalent figures were one course in seven for Japan, three courses in sixteen in Sweden, and one in seven in Norway. Looking at the Norwegian case in more detail, easily the largest of all vocational programmes at the upper secondary level are the "clerical and commercial" and the "manual and industrial" lines. In 1982, nearly 70 per cent of trainees in the former were girls, who, however, comprised a mere 15 per cent of the industrial course.

The same patterns of choice and division found in school are, not surprisingly, repeated in further and higher education. Chart B shows the overall breakdown of courses followed by women in 17 countries, and it is clear that, throughout OECD countries, female students remain outside the science and technical fields.

Indeed, there are indications that at this level, too, the traditionally female programmes and faculties are becoming still more feminized. This is worrying because job opportunites for arts and humanities students have been severely curtailed in recent years. Moreover, it is precisely the courses where girls and women are concentrated that are most at risk of being downgraded in academic standing and resources in the course of present cutbacks in higher education[3].

Canadian examples illustrate the trend towards feminization at university level. Only just over half the undergraduates in the education faculties were female at the beginning of the 1970s but, by 1982, women made up over seven in ten of these students. Women were less than half of the humanities undergraduates in 1970 but 62 per cent by 1982.

Women Lose as the Rules of the Game Change

The fact that the most valued courses and qualifications have remained male dominated means that the observed increase of female participation in them may well be only enough to ensure that the position of women has not actually deteriorated. Educational advantage is thus a moving target and, as girls and women cross one barrier in the direction of greater equality, the "rules of the game" change and new barriers emerge.

Whereas previously, for instance, a university degree by itself would have been sufficient to ensure reasonable future prospects, these prospects are now more dependent upon the kind of degree attained and the faculty that has issued it. Although the steps to be taken towards realizing genuine equality between the sexes in education must go beyond the classroom to touch the attitudes and beliefs of society itself, much can be achieved within schools and colleges. ■

3. Policies for Higher Education in the 1980s, *OECD, Paris, 1983.*

Development Aid: The Most Recent Results

In 1985, Official Development Assistance (ODA) from countries which are members of OECD's Development Assistance Committee (DAC) reached $29.6 billion for the group. This represented an increase of $0.8 billion or 3 per cent over 1984. In real terms, i.e., measured in constant (1984) prices and exchange rates, DAC ODA rose by 1.8 per cent. Bilateral DAC aid rose by as much as 12 per cent, largely reflecting the response by DAC members to the special problems of Sub-Saharan Africa, both in the form of emergency aid and assistance to help African countries in their structural adjustment efforts. A particularly significant parallel development in this regard is the strong increase in resources raised for emergency and development purposes by private voluntary agencies in DAC countries (not included in the ODA figures) which reached over $3 billion in 1985.

Contributions to multilateral institutions recorded in 1985 (which are included) declined. However, this reflected the accidental timing of contributions of a number of major donors, especially to the World Bank's International Development Association (IDA), holding back the overall DAC aid growth rate which, in the absence of this accidental factor, would have exceeded the trend rate recorded in recent years of 3.5 per cent in real terms.

It is also this factor which, together with accelerated GNP growth in the DAC Member countries, explains the slight decline in the ODA/GNP ratio from 0.36 per cent to 0.35 per cent.

Among DAC members, *Norway* ranked highest in 1985 in terms of the share of its GNP devoted to aid, with an ODA/GNP ratio of 1.0 per cent. Other donors exceeding the 0.7 per cent target are – as in recent years – the *Netherlands, Sweden,*

Above: *The rise in bilateral aid by DAC donors reflects their response to the problems of Sub-Saharan Africa.* Below: *The Scandinavian countries still top the list of aid donors, along with the Netherlands.*

Denmark and *France* (if DOM/TOM aid is included). Large increases in percentage terms were reported by Austria, Finland, Sweden, Ireland, Germany and Switzerland. The largest expansion of ODA volume in absolute terms was recorded by the United States, Germany, France and Sweden.

Individual DAC Countries

Australia's ODA disbursements in 1985 increased in national currency by 21 per cent, and in real terms by 13 per cent, to US$ 749 million. As a per cent of GNP, ODA disbursements rose to 0.49 per cent compared with 0.45 per cent in 1984. The increase was largely the result of higher deposits of notes with IDA. The Australian Government has stated its intention to increase its aid programme in real terms.

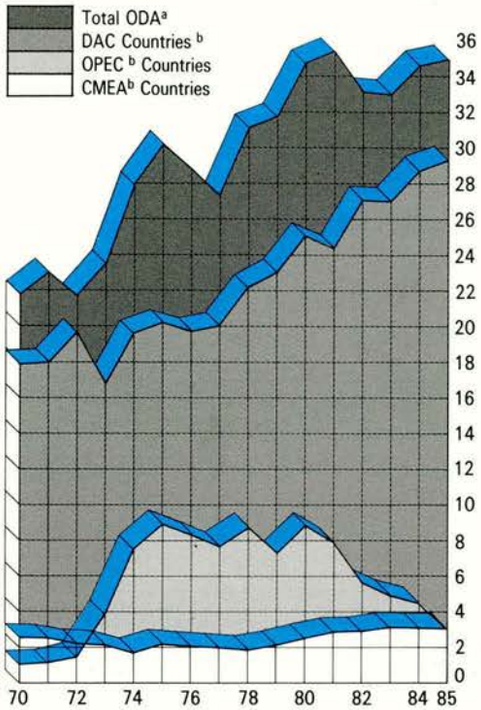
Austria's ODA net disbursements increased significantly in 1985 compared with 1984, both in national currency (41 per cent) and real terms (38 per cent). The ODA/GNP ratio progressed from 0.28 to 0.38 per cent. However, as regards bilateral ODA, the increase was almost exclusively due to higher disbursements of official concessional export credits and, as regards multilateral ODA, to a bunching of deposits with international financial institutions. As both these items are expected to be significantly lower in 1986, the prospect is for a decline in Austria's ODA in 1986 and following years.

Belgium's ODA remained stable in national currency in 1985 but fell by 5 per cent in real terms to $430 million; expressed as a proportion of GNP, ODA decreased from 0.57 per cent in 1984 to 0.53 per cent in 1985. The decline reflects the impact of budgetary factors which reduced commitment levels, and reductions in official contributions associated with private export credits, which met delays arising from the application of aid criteria and the identification of eligible projects. Multilateral contributions were also lower, mainly for reasons relating to the timing of notes. The Belgian ODA/GNP ratio is likely during the next few years to remain within a range of 0.55 to 0.60 per cent of GNP.

Canada's ODA disbursements in 1985 increased by 6 per cent in national currency and 3 per cent in real terms to US$1.64 billion. However, as a percent of GNP, it fell from 0.50 per cent in 1984 to 0.49 per cent in 1985. While net bilateral loans fell considerably, bilateral grants increased slightly, and contributions to multilateral agencies, in particular to IDA, rose significantly. The Canadian Government recently decided to stabilize ODA volume at 0.50 per cent of GNP until 1990, so ODA may be expected to increase roughly in line with the growth of Canada's GNP over the next few years.

A. AID BY THE MAJOR DONOR GROUPS

ODA at 1984 prices and exchange rates ($ billion)



a. Bilateral aid and aid from multilateral agencies.
b. Bilateral aid and contributions to multilateral agencies.

Denmark's ODA disbursements in 1985 corresponded to 0.80 per cent of GNP. Compared with the previous year, this represented a decline of 0.05 points from 0.85 per cent of GNP. The reduction was exclusively due to a bunching of multilateral contributions in 1984 and does not represent a trend. On the contrary, Denmark's ODA volume is expected to increase significantly, in view of the Government's recent decision to increase the aid budget gradually to 1 per cent of GNP in 1992.

The growth of *Finland's* ODA since 1978, when the Government undertook to reach the 0.7 per cent target by the end of the present decade, continues to be one of the most rapid and sustained among DAC countries. Rising by 15 per cent in real terms, ODA at 0.39 per cent of GNP in 1985 was for the first time above the DAC average. ODA appropriations for 1986 amount to 0.47 per cent of GNP, and are to reach 0.55 per cent in 1987.

France's ODA to independent countries (i.e., excluding flows to the DOM/TOM), which the French Government will endeavour to raise to a level of 0.7 per cent of GNP in 1988 or as soon as possible thereafter, continued to progress rapidly, reaching 0.54 per cent of GNP in 1985. An increase in multilateral contributions, in particular to IDA, and a substantial rise in net bilateral lending accounted for the growth of aid in 1985.

Germany's ODA in 1985 recovered by 9 per cent in national currency and 7 per cent in real terms. As a percentage of GNP it rose from 0.45 per cent in 1984 to 0.47 per cent in 1985. This increase resulted mainly from a substantial rise in the bilateral aid programme and multilateral contributions, the latter mainly due to a higher deposit of funds with IDA. The current medium-term assistance plan provides for an average annual growth rate of aid appropriations of 2.9 per cent until 1989, which could lead to some further increase in ODA in real terms in this period.

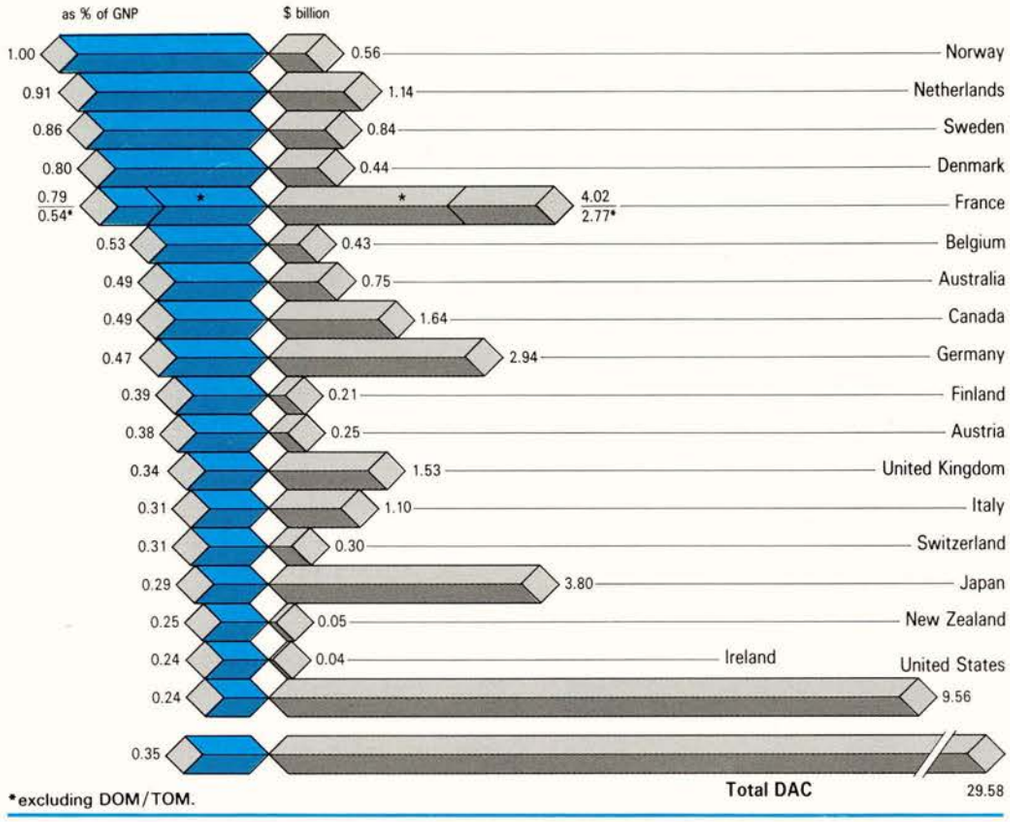
Ireland, which joined the DAC in November 1985, began to extend ODA in the Sixties and expanded its aid programme after joining the EEC in 1973. Disbursements have been on a rising trend since, increasing to 0.22 per cent of GNP in 1984. In 1985, they rose by a further 9 per cent in real terms to $39 million or 0.24 per cent of GNP. The increase was spread over both the bilateral and the multilateral programmes. On present aid policies, the upward trend in Ireland's ODA can be expected to be maintained.

The rapid rise in *Italy's* ODA was temporarily interrupted in 1985. Although budget allocations increased, timing factors affected multilateral disbursements. As a result, although bilateral disbursements continued to progress, rising by 25 per cent in real terms, total ODA fell by 3 per cent in real terms to $1.1 billion and decreased as a proportion of GNP from 0.33 per cent in 1984 to 0.31 per cent in 1985. A resumption of growth can be expected in 1986 and beyond, as Italy progresses towards achievement of the 0.7 per cent target.

The rapid expansion of *Japan's* ODA met with a temporary setback in 1985, mainly due to the timing of its multilateral contributions, while bilateral ODA increased by 5.3 per cent over the previous year, including an increase in grants of 11.4 per cent. Two instalments of Japan's contributions to IDA, amounting to $1.2 billion, having been paid in 1984, disbursements in this area fell back by more than $600 million in 1985. Japan's ODA/GNP ratio fell from 0.34 per cent in 1984 to 0.29 per cent in 1985. The prospects for ODA disbursements in the coming years are more favourable under the newly established Third Medium-term Target for 1986-92.

The Netherlands' aid, which has exceeded the 0.7 per cent target every year since 1973, fell by 10 per cent in real terms in 1985 and declined as a proportion of GNP from 1.02 to 0.91 per cent. The decrease, which affected all the major components of the aid programme, can be expected to be temporary, given the Netherlands Government's continued commitment to devote 1.5 per cent of net national income to development co-opera-

B. ODA FROM DAC COUNTRIES IN 1985



*excluding DOM/TOM.

tion. ODA disbursements may accordingly be expected to recover to a level close to 1 per cent of GNP in the coming years.

New Zealand's ODA/GNP ratio, which had been on a downward trend since the mid-1970s, stabilized in 1985 at 0.25 per cent, the same result as in 1984. ODA disbursements rose by 15 per cent in nominal terms and 2 per cent in real terms. The main development was an enhanced aid effort in Sub-Saharan African countries. Despite the government's vigorous efforts to reduce New Zealand's budget deficit, it has indicated that there should be a recovery in the real level of aid in the near future.

Norway's ODA in 1985 increased by 8 per cent in national currency and 2 per cent in real terms. At 1 per cent of GNP, its ODA/GNP ratio was the highest among the DAC countries in 1985 (it reached 1.03 per cent in 1984). Given the government's strong commitment to aid objectives, the ODA/GNP ratio may remain at around the current level, despite Norway's serious current economic difficulties.

Sweden's ODA disbursements in 1985 rose by 18 per cent in national currency and 10.5 per cent in real terms. As a percent of GNP, ODA recovered from 0.80 per cent in 1984 to 0.86 per cent in 1985. All parts of the programme participated in this recovery; the increase in bilateral grant aid was particularly notable, due mainly to a major aid effort in Sub-Saharan Africa. Appropriations are presently planned to remain at a level corresponding to 1 per cent of GNP.

In 1985, *Switzerland's* ODA increased by 7 per cent in real terms, and progressed from 0.30 to 0.31 per cent as a proportion of GNP. This increase was due mainly to higher multilateral outflows, in particular to regional development banks. Switzerland's ODA may be expected to further increase moderately in real terms and as a percentage of GNP.

The *United Kingdom's* ODA increased in 1985 in national currency by 10.4 per cent and by 4.6 per cent in real terms. As a percentage of GNP it rose to 0.34 per cent. Considerable impetus was given to disbursements by a substantial rise in aid to Sub-Saharan African countries. The British authorities expect that on present plans up to 1988/1989, aid levels will be more than maintained in real terms. This may nevertheless imply a slight decline in the ODA/GNP ratio over the same period.

The sustained expansion of the *United States'* ODA in real terms continued in 1985, with a rise of 6.2 per cent over 1984 to a record level of $9.6 billion. The substantial growth of United States aid did not, however, lead to a change in the ODA/GNP ratio for the United States, owing to the rapid growth of GNP. An increase of close to $1.9 billion in bilateral disbursements, largely in the form of Economic Support Fund assistance (principally to the Middle East) but also in food aid and other grants to Sub-Saharan African countries, more than made up for a temporary $1 billion decline in contributions to multilateral organizations (which reflected a delay in the fiscal year 1986 contribution until January 1986). Growing concern regarding the size of the Federal budget deficit is a source of future uncertainty, but the impact of budget cuts is not likely to be visible in calendar year 1986 disbursements.

AID from non-DAC Countries

Aid disbursements from OPEC countries continued to decline and, according to preliminary estimates, fell to $3 billion in 1985. However, Kuwait and Saudi Arabia remained the world's leading aid donors in relation to GNP. The decline in OPEC aid concerned bilateral aid programmes (although aid to Sub-Saharan Africa increased somewhat to $0.6 billion).

CMEA countries' net aid disbursements remained essentially stable at a level of about $3.0 billion. The bulk, almost exclusively bilateral, was provided by the USSR and primarily to Cuba, Mongolia and Vietnam: together these three countries continued to receive three quarters of total CMEA aid.

Developing Countries' ODA and Other Receipts

Total Official Development Finance to developing countries from all sources (including not only DAC bilateral ODA but also OPEC and CMEA aid and concessional and other development finance from the multilateral institutions) continued to increase and now accounts for about 60 per cent of the net financial resource flows to developing countries, compared with 45 per cent in 1975.

However, export credits and bank lending continued to decline, according to preliminary estimates, albeit at a slower rate than in 1982-1984, thus leading to a further slight contraction in total net resource flows to developing countries. Both elements are expected to increase moderately in 1986. The fall in bank lending in 1985 was offset by a surge in bond lending (essentially floating rate notes) so that combined bank/bond finance stabilized in 1985. Direct investment continued to decline.

Severe adjustment programmes generally implied less recourse to external finance, with cuts in imports and in new projects. Except for Asian countries, imports in 1985 were below their 1981 levels. The decline, however, was less marked than the fall in the net receipts of external financial resources during the same period. A main reason is that the annual outflow of residents' capital from the capital importing countries has declined sharply. According to an estimate by IMF in its *1986 World Economic Outlook*, it was $25 billion lower in 1985 than in 1982. ■

Towards Freer Trade in Services: Audiovisuals

The striking technological and commercial changes in audiovisuals have made it necessary to update and strengthen OECD's Code of Liberalization of Current Invisible Operations for this type of service. OECD's Committee on Capital Movements and Invisible Transactions (CMIT) and its group of audiovisual experts has just completed a study which reviews recent developments in this field and the policies and measures affecting international trade in audiovisual services.[1]

It took less than 20 years for commercial television to succeed the cinema as the main medium for audiovisuals. Now television is coming to an end, at least in its traditional form. For the second time in less than half a century, the audiovisual scene is being completely transformed, this time by the electronic revolution of the 1970s. Micro-circuits and computers have made available a whole range of new communications media which originate not only within but beyond the frontiers of OECD Member countries: teleprocessing (real time computing via remote terminals, consultation of data banks), cable distribution and satellite broadcasting (a menu of varied programmes, pay television, videoconferences, videophones), interactive and digital television (videotex services, digital videodiscs, etc.).

These technological developments have given both individuals and firms the choice between several means of access to audiovisual works. As a result, more and more money is being spent on acquiring new equipment (microcomputers, videorecorders, computer terminals) and products (videogames, software, audiovisual programmes), and more time is being devoted to their use.

The most important impact, however, may be in the field of international trade. The new distribution media have made possible a rapid increase in the transmission of audiovisual works from one country to another and even from continent to continent. Thus audiovisual markets have become worldwide, with cable television networks and direct broadcasting satellites able to transcend national frontiers, and cassettes and videodiscs made in New York or London being sold in Sydney or Tokyo.

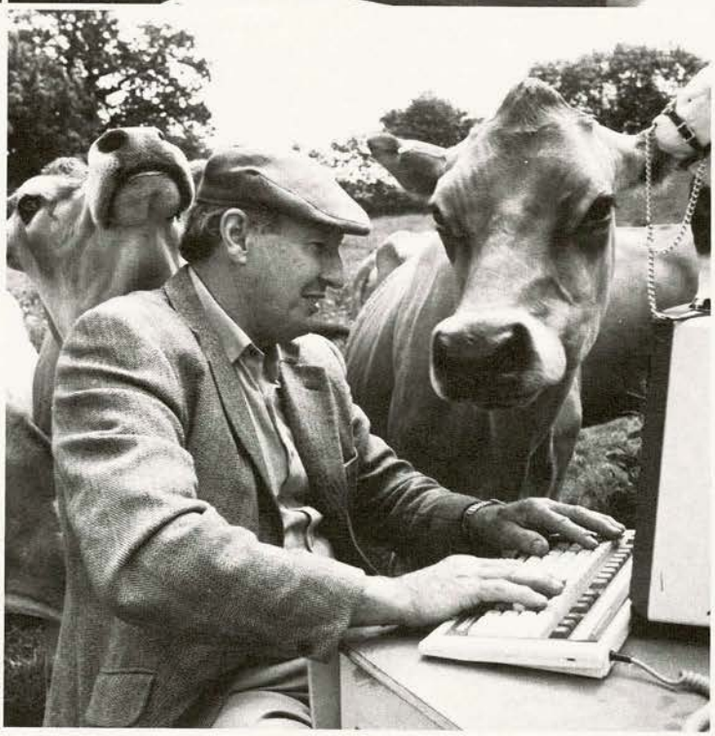
Until now, most OECD Member countries have tried to keep some control over trade in audiovisual production and services, but the new communications systems are not usually covered by traditional regulations. Thus Member countries have been trying to plug the gaps. The question is whether the provisional solutions opted for several years ago will brake the internationalization process and, perhaps more important, whether they can be maintained, in the face of rapid technological and commercial change.

Trade is Still Controlled

Within the audiovisual sector, television networks, cinema theatres and other new media, such as pay television, provide 500,000 jobs and have an annual turnover of some $26 billion (see box). Most of these transactions take place within national frontiers: exports of audiovisual works amount to no more than $1 billion, $600 million for films and $400 million for TV programmes and videofilms. This is partly explained by spectators' affinity for their own language and cultural traditions but also by the subsidies and other protection provided for by many OECD countries for their national industries. Yet the cultural impact of even this small volume of trade is by no means negligible, as is evident from the size of the audiences for a large number of foreign television soap operas and the number of foreign film posters to be found in large cities. The United States has the largest share of this market: in 1980, U.S. producers exported $450 million worth of films for cinemas (France, though in second position, exported only $15 million worth) and $350 million worth of TV programmes (the United Kingdom, second biggest exporter of television films sold $22 million worth abroad). These disparities are clearly not irrelevant to the audiovisual policies pursued by certain countries.

The reasons put foward by governments

1. International Trade in Services: Audiovisual Works, *to be published shortly.*



for protecting their citizens from too great a liberalization of trade are not only economic but cultural as well: in certain OECD countries, the authorities consider it their duty to support the home industry or to restrict imports of foreign audiovisuals so as to keep their cultural identity. Often this means making domestic audiovisuals more competitive internationally. The conditions in which audiovisual firms are allowed to "establish" themselves, customs regulations, copyright rules, and other measures, have a similar *raison d'être.*

Policies for Television

Thus in fact, even if not in principle, in most OECD countries there is some distinction between domestic and foreign firms as to market access. Most Member countries recognize the right of any foreign company – whether a producer, a processor (of picture or sound), a distributor or seller of audiovisual works – to freely establish on their territory. And once installed, the foreign firm is generally treated in the same way as its domestic counterparts.

Yet it cannot be said that public television channels fail to favour domestic production in their purchasing policies or that there are no restrictive regulations on production or co-production of cinema or TV films by foreign firms. In France, Germany and Switzerland for example, any work benefiting from governmental aid to production must go through local studios (e.g. for dubbing) or laboratories (for copying). Most countries (with the exception of Austria, Australia, Japan, Switzerland, Turkey, the United Kindgom and the United States) have subsidized the distribution of domestic films. In France, Italy and Portugal there are screen quotas for cinemas and, in Australia, Canada, France, Sweden and the United Kingdom, for television broadcasts.

Establishment of foreign enterprises in television is limited by the fact that there is often a monopoly in broadcasting and in telecommunications more generally. But with changes in public taste and the appearance of new media, the role of these monopolies is changing and increasingly the subject of public debate.

New Media

The transition to the age of electronic communications has revived the issue of trade restrictions. Cable television networks, direct broadcasting satellites, videocasettes and videodiscs all provide ways of getting around the obstacles set up by governments to free circulation of audiovisual culture. Faced with internationalization of all parts of the industry, governments at first tried to tackle the most pressing problems by adapting existing regulations. Later they established more

Micro-circuits and computers have made available new communications media which have changed the nature of audiovisuals. OECD is trying to minimize the barriers to their transmission.

comprehensive plans, which took account not only of present technology but also its likely evolution. But it is difficult to find an equilibrium between the protection of national identity still deemed necessary in many countries and the move towards liberalization of trade in audiovisuals.

In the early 1970s, the development of cable television enabled many Belgians and Canadians, for example, to pick up the TV broadcasts of their immediate neighbours, at least if they lived near the border. These "pirate imports" raise various economic problems – loss of advertising revenue for domestic programmes, cultural difficulties (for linguistic minorities) and political issues (insofar as they are seen by some governments as an infringement of their sovereignty). Recently the problems raised by cable distribution at the border have become more intense because broadcasting satellites allow programmes to reach viewers in many countries, either through cable networks or directly – if the recipients have the right antenna. The reaction has been rapid: some Member governments have regulated (and others prohibited) foreign advertising and have, through international agreements, limited satellite transmission across borders.

Another medium with a rapidly growing mass market – videocassettes and videodiscs – is even more difficult for governments to control since television monopolies or regulations have little effect on them. Some governments have tried to limit the audience by imposing – in addition to basic regulations having to do with violence and pornography – special taxes on equipment (videorecorders and cassettes).

During the 1980s, the audiovisual policies of OECD countries have evolved and will continue to do so. Piecemeal measures are beginning to give way to specific plans for developing cable networks, direct broadcasting satellites and video transmission systems. The same process is going on in programming, where there is both technical innovation (computer-assisted design, computer-created graphics) and economic and financial redeployment. It is the cable networks and satellites that are attracting the most government attention. Where telecommunications are a government monopoly – and such is the case in most Member countries – there is a clear trend towards allowing some competition for this pillar of the new international communications system. In some countries this trend is viewed as compatible with an active government telecommunications policy; in others, deregulation and privatization are the order of the day.

In recent years, there have been some experiments in bilateral and multilateral co-operation in satellites (ten or so satellites are to be launched in Europe by the end of the decade), but these projects focus more on technical infrastructure than on programmes. As to cable distribution, →

AUDIOVISUAL SERVICES: A $26 BILLION BUSINESS

The annual turnover of the "mass consumption", audiovisual market (television broadcasts, cinema, pay television, etc.) amounts to about $26 billion for the OECD countries, according to the latest available statistics (almost half of this earned by United States firms). The figures are broken down as follows:

- *Television networks; $18 billion*
- *Cinema: $6 billion;*
- *New distribution media (pay television, videocassettes and videodiscs): $2 billion.*

As regards "consumer" equipment, it should be pointed out that the OECD area alone has 350 million television receivers out of a world total of 500 million.

Source: Unesco Statistical Yearbook, *1984.*

development so far has usually been on a national basis; there has been little co-operation between countries, and only a few international links are presently planned. It is already apparent that there may be problems of technical incompatibility which could become an obstacle to the exchange of programmes.

The Outlook

Thus the definition of government policies is far from complete: a number of the problems facing Member countries – individually or in the context of international co-operation – have not yet been resolved. In addition to the already mentioned cable incompatability, there are other difficulties: unequal distribution of technical infrastructures and receiving equipment among countries, different attitudes towards the relative decline of the cinema in the face of rapid growth in cable television and video-recording, etc. The differences in the regulations adopted by Member countries may themselves constitute a brake on internationalization and integration. These include disparities in legislation on advertising (for alcohol and tobacco, for example), on protection of minors and on the notion of libel. There are also differences in taxation on certain kinds of audiovisuals and distribution channels. Depending on its classification, a work may be imported duty free or may be taxed; and its distribution may be free of control or subject to delays and even quotas.

Another important obstacle: the disparity between, or inappropriateness of, laws that protect copyright. The pirating of videocassettes and the difficulty of obtaining satisfactory remuneration for authors, if the new media transmit works in several countries, could harm the long term development of the audiovisual sector as a whole and also its internationalization, unless new solutions are found.

Harmonization of national laws on all aspects of the audiovisual scene is no doubt an unrealistic objective, since some of the disparities stem from differences in culture or societal choices. Yet the strengthening of international co-operation is necessary if the enormous potential of the new media is to be fully exploited. Moreover, international co-operation may help reconcile the various aims of laws in this field: facilitating consumers' access to the entire range of audiovisual services, ensuring that market mechanisms are not distorted, guaranteeing creative individuals a just recompense for their labour and preserving the identity and vitality of cultures. The CMIT and its expert group on audiovisual works is helping to strengthen international co-operation and are presently drawing up new rules of the game for Member countries, to be added to those already in the OECD's Code of Liberalization of Current Invisible Operations.

The move from a few radio and television channels to tens – and soon hundreds – of channels, through a combination of cable networks and satellite broadcasting, is more than a quantitative change; it is a qualitative leap in audiovisual consumption and means of communication. But it can be successfully achieved only if the problems connected with information and telecommunications services are resolved at international level. ■

WHAT IS AN AUDIOVISUAL WORK?

The present "films" section of OECD's Invisibles Code, which dates from 1961, does not take account of the new means of international communication, in particular cables and satellites. The concept of film thus needs to be extended to the more modern term "audiovisual work". The Group of Experts of the Committee on Capital Movements and Invisible Transactions (CMIT) now defines an audiovisual work as any animated sequence of pictures accompanied by sound. Such works may:

- *Be recorded on a physical medium (film, magnetic tape, videocassette, videodisc, etc.)*
- *Be transmitted or broadcast directly (by cable, airwaves, etc.), for example live transmission of sporting events or cultural performances*
- *Be used by one or more individuals or corporate bodies for private, semi-commercial or commercial purposes, for example cinema performances, television broadcasts, and in particular dial-a-programme television and videotex transmissions of audiovisual works*
- *Have cultural, educational, scientific, advertising, or entertainment content, for example.*

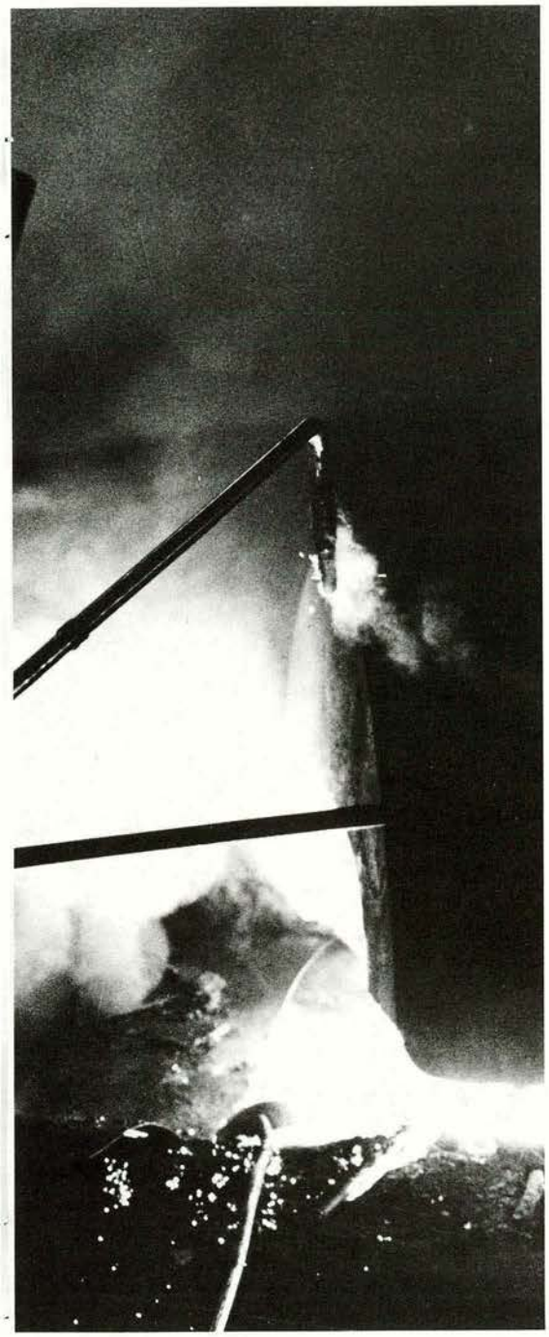
The following are excluded from the definition: pure sound material (except when this constitutes the sound track of an audiovisual work), texts, data, facsimiles, certain types of communications (communications between computers, picturephones, video conferences and teletext, in cases where the messages transmitted in digital or other coded forms do not constitute audiovisual works).

Some audiovisual works likely to appear in the future: video mail order catalogues (if they contain sequences of animated pictures) or computer-created images and sound.

Coun

In heavy industries like steel and shipbuilding, excess capacity, deteriorating competitiveness and falling profit margins have caused a sharp fall in industrial employment. But overall, the number of jobs is now expected to rise.

try Problems and Strategies



Spain

Although there has been an improvement in underlying economic conditions, the short-term performance of the Spanish economy over the last two years or so has been uneven. GNP grew by 2 per cent in 1985, with domestic demand taking over from net exports as the main source of strength, while the current external surplus surged to $3 billion (some 1.7 per cent of GDP). On the other hand, the unemployment rate (22 per cent) and inflation (8.7 per cent in the 12 months to March 1986) are still high.

Conditions for sustained non-inflationary growth are now in the process of being restored. A few years ago, Spain was confronted with deep-rooted structural problems, stemming mainly from its failure to adjust to the new conditions brought about by the two oil shocks. Slower output and productivity growth, an excessive rise in average labour costs, labour market rigidities, a reversal of migration flows, and a steady long-term outflow of labour from agriculture all contributed to the sharp increase in the unemployment rate. Government deficits widened significantly, largely reflecting the deterioration of the social security accounts and transfers to loss-making industries. At the same time, Spain's energy consumption remained excessive and too dependent on imported energy, especially oil.

It was not until 1983 that the government adopted a more determined, coherent and long-term approach to tackling these problems at source. Measures have since been taken to facilitate structural adjustment in industry, to bring the social security system into balance, to encourage a more rational and efficient use of energy and to foster private productive investment. Efforts have also been made to increase the flexibility of the labour market, with a view to reducing unemployment.

By 1985, the social security accounts were in deficit to the tune of 4¼ per cent of GDP, compared with ¾ per cent in 1977. This largely reflected the adverse effects of earlier reforms (which had increased benefits without a commensurate rise in contributions), structural deficiencies on the revenue side (characterized by high but uneven rates of contribution, coupled with a narrow though gradually broadening base) and slower growth.

Since 1984, determined action has been taken to correct the most obvious faults in the system. The new measures have sought to rationalize its structure, to eradicate fraud more effectively and to reduce the gap between benefits and contributions, especially in the pension system. However, not all measures have aimed at cutting the deficit. While in some cases, the level of benefit has indeed been reduced or a ceiling imposed, in others, inequities have been removed at the cost of extending or raising transfers (e.g. health). Nonetheless, these steps are expected on balance to moderate the long-term upward trend of the deficit.

Industrial structural adjustment was also delayed. Sheltered from the first oil shock by a cut in taxes on oil products and cushioned by the high rate of inflation, the persistence of negative interest rates and high tariff barriers, heavy industries like steel and shipbuilding continued to invest heavily in new capacity, despite the downturn in world demand and the increasingly competitive international environment. The emergence of excess capacity coincided with rapidly increasing labour costs, resulting in worsening competitiveness and falling profit margins and bringing in its wake a sharp contraction in industrial employment. The situation finally came to a head with the 1980 recession when, in addition, the government allowed the price of oil to rise more in line with world trends while real interest rates turned strongly positive.

The authorities' first attempt to foster the long-overdue structural adjustment of Spanish industry was embodied in the 1981 law on industrial reconversion. This scheme, however, proved difficult to administer and more costly than expected, with government funds mainly being used to soak up losses. A more comprehensive strategy was adopted in 1983, with the publication of a White Paper on reindustrialization, which was followed in 1984 by the passing of a new law. Its aim was to improve productivity and restore profitability in the industries in greatest difficulty through the elimination of excess capacity and overmanning and the restructuring of financial liabilities. At the same time, investment in new technologies was to be promoted in those sectors with the greatest growth and profit potential.

This programme provided for a further reduction of employment in the sectors concerned, with over half the jobs lost coming from the iron, steel and shipbuilding industries. The regions most affected were designated as Zones of Urgent Reindustrialization (ZUR), and both existing and new firms were given financial incentives to settle there. In addition to this programme, general schemes have since been introduced to channel resources into productive activities, including incentives for investing in new technologies and greater support to small- and medium-sized businesses. →

Specific measures have also been taken to reduce the losses of public sector enterprises, which amounted to around 1½ per cent of GDP in 1983. These succeeded in cutting the losses by about 14 per cent in real terms in the two years to 1985.

On the energy front, a National Energy Plan for the 1984-1992 period has been launched to bring about a more efficient use of energy, reduce the country's dependence on imports (especially of oil) and provide for an appropriate development of oil refining and electricity generation capacity in line with a smaller projected rise in demand than originally anticipated. Domestic energy prices have been raised to help reverse the increase in energy consumption per unit of output which occurred during the 1970s, when other OECD countries considerably reduced their energy use as a percentage of GDP.

The most critical problem for Spanish policymakers, not just economically but politically and socially, remains unemployment. The 22 per cent unemployment rate in 1985 was the culmination of a 10-year period during which total employment in Spain had fallen by 19 per cent. Nonetheless, the recorded rate of unemployment probably exaggerates the problem, given the suspected size of the underground economy.

While the labour force has grown more rapidly than in the OECD area as a whole, this has been partially offset by a fall in participation rates as people have been discouraged by the difficulties of finding employment and cushioned by rising welfare payments. In particular, the female participation rate is exceptionally low, while older people have left the labour force, attracted by higher pensions and early retirement schemes. It is the young that have suffered most, with youth employment falling by up to 68 per cent (for 16 to 19-year olds).

The slowdown in labour demand after the first oil shock coincided with the accelerating exodus from agriculture (agricultural employment falling by 4 per cent a year from 1976 to 1985), and was particularly acute in industry (especially in construction, mining and manufacturing). This was partly due to the large degree of labour hoarding in Spanish industry, already evident by 1975, and the sudden need to achieve higher productivity and lower unit labour costs as economic conditions deteriorated. Wage increases did not moderate until the early 1980s. As a result, between 1975 and 1979, the real wage gap in industry (the difference between the real growth of wages and productivity growth) increased by around 22 per cent. Since wage rises have traditionally been tied to price rises, the system has had the effect of at least maintaining real wages at the expense of higher unemployment. The unwinding of this wage-price spiral has been extremely difficult to bring about. Furthermore, the fact that unemployment continued to rise remorselessly up to 1985 while the rate of capacity utilization remained more or less unchanged suggests that a reduction in unemployment can only be brought about by substantial capital-widening investment.

A three-pronged strategy to reverse the rise in unemployment was initiated in 1983. It aimed at reducing the size of the labour force, encouraging the recruitment of idle labour and improving labour market flexibility. Early retirement has been provided for, tax incentives have been granted to firms taking on young workers, the public sector has been urged to increase recruitment, especially from the ranks of the long-term unemployed, and the regulations governing part-time work and limited-duration contracts have been eased with a view to promoting the hiring of idle labour.

These strengthened Employment Promotion Programmes resulted in the hiring of over 1 million people in 1985, compared to an average of about 450,000 a year between 1979 and 1984. They have thus helped bring to an end the long-term decline in employment. This turnround should be consolidated in 1986, when cyclical, structural and institutional factors are all expected to contribute to a reversal of the unfavourable labour market conditions of the past 10 years. That does not mean the unemployment rate will necessarily fall rapidly, but neither should it mask the significant improvement in labour market conditions, which is better reflected in the projected rise in employment.

Over the last few years, the structural policies pursued by the Spanish authorities have helped to correct the most serious imbalances underlying the relatively poor economic performance of the economy. Industrial restructuring is well under way. The social security system in general, and the pension system in particular, have begun to be rationalized. Energy conservation has been stepped up. Labour market flexibility has been improved by liberalizing work contracts. The growth potential of the economy, already relatively high by OECD standards, has no doubt been enhanced by these policies. Yet, if full advantage is to be taken of this growth potential and of the more favourable international environment, fiscal retrenchment should be given priority together with the fight against inflation. Efforts should continue to contain real wage growth in line with the rise in underlying productivity. Only in this way will the rise in economic adjustment be durable and growth be spread more evenly in the form of higher employment. ■

Portugal's population and labour force have fluctuated as the migration balance has changed. From 1982 onwards, emigrant workers have been returning home.

Portugal

Portugal's economic situation has improved considerably since 1983 when a strict austerity policy was introduced. This programme, made necessary by a trade deficit amounting to 13 per cent of GDP at end-1982, and supported by the IMF, was designed to reduce imports by cutting purchasing power (by 3 and 4 per cent respectively in 1983 and 1984) and imposing tighter credit controls. It was also supposed to increase competitivity and hence exports by devaluing the escudo (by 12 per cent in June 1983, and afterwards by a crawling-peg devaluation of one per cent a month). The policy proved effective: the external balance improved rapidly and showed a surplus of $300 million in 1985.

However, the economy is beset with serious problems in other areas. The inflation rate, though it has fallen appreciably since the second half of 1984, was still 17 per cent at the end of 1985, and investment slumped during the period of austerity. Unemployment would seem to have stabilized, though at the high level of 8.5 per cent while public finance has been marked by chronic deficits for the past twelve years.

Indeed, since 1975, after the shift from an orthodox approach (balanced budget) to an active and expansionary use of fiscal policy, Portugal has had to contend with large general government deficits, amounting to between 5 and 13 per cent of GDP. And these deficits may have been even larger since, until now, not all general government transactions have always been recorded.

The public debt, which was less than 20 per cent of GDP in 1974, had reached some 65 per cent by 1985. As a result, general government outlays on interest payments on this debt have been almost as high as the deficit itself in recent years. Thus, even if one adjusts for the impact of inflation on real debt, the latter carries heavy constraints and restricts the scope of current policy. Moreover, the deficits exert pressure on money creation.

Looking beyond the record of the immediate past, there are underlying causes for the deficits. In Portugal, as in all other industrialized countries, social spending is rising. New measures have been taken – job creation schemes and temporary exemption of young people and their employers from social insurance contributions. Economic subsidies are sizeable in a number of sectors, particularly for public enterprises. But structural measures are still needed if there is to be a sustained improvement in the foreign payments position.

On the government revenue side, tax and social insurance contributions account for only about 30 per cent of GDP, a low yield which is attributable to the narrowness of the tax base. With the introduction of value added taxes (VAT), Portugal has at its disposal a broadly-based, low-rate tax with a higher yield than those it replaces. In addition, the emphasis is now on lowering tax rates for dependent workers and on measures to combat tax evasion and avoidance.

One of the aims of the budget for 1986, and probably succeeding years, is to reduce the public sector deficit. The Portuguese government plans to impart greater transparency to government accounts by including in them the expenditure and income of autonomous funds. The same concern is reflected in its intention to borrow from the market, in the form of bond and Treasury bill issues, to finance the public debt.

Ultimately, more than half of the deficit is expected to be funded in this way. The 1986 budget is to be part of an overall plan for public finance which will extend well beyond a one-year time horizon, setting limits on the accumulation of deficits bringing them into equilibrium (if interest payments are excluded from the calculation). As to public enterprises, they should try to become more efficient. As one step in this process, programme contracts, which include a set of targets, are being set up between the firm and the government. There are also contracts between the government and the management of the firm (providing profit-sharing arrangements with the intention of making management more stable).

Thus fiscal policy is directed towards bringing public finance under greater control in the medium term. Restrictions on public consumption are aimed at stabilizing the number of civil servants and also current expenditure in nominal terms. Other measures mark a shift away from the austerity policy, with reduced tax and social insurance contributions, higher social benefits, and a pick-up in public investment under the impetus of projects co-financed with the EEC.

Unemployment is another major concern. From a low level in 1973, it rose much faster in Portugal than in the other OECD Member countries between 1974 and 1979, stabilizing since then at around 8-9 per cent. The official unemployment rate is currently slightly above the average for OECD as a whole and below the European average. An analysis of labour market components reveals some mismatches that constitute one source of this unemployment. Labour supply is, of course, determined by both population trends and labour-force participation rates. With regard to the first factor, Portugal's population has fluctuated over the past 20 years as a result of continuing high natural growth and substantial migratory movements. A country of net emigration until 1973 and again between 1976 and 1981, Portugal suddenly experienced a steep rise in its population in 1974-75 with the arrival of its former colonial settlers, and again from 1982 onwards, though on a smaller scale, as a result of recession in host countries employing Portugal's emigrant workers. These migrations have had a considerable impact on the size of the potential labour force.

The lack of coherent statistics makes it difficult to analyse accurately the other components of labour supply. Between 1974 and 1982 the participation rate did

not show any clear trend. It is the product of two offsetting movements: an underlying decline in the male participation rate and an underlying rise in female participation. Fluctuations around the trend would seem to derive not so much from negative growth of real wages paid to workers as from the impact of unemployment (the "discouraged worker" hypothesis in which labour market slack reduces labour supply). It is also likely that the rural labour force has, as a result of overall employment difficulties in the economy, fluctuated around a generally downward trend. The rise in agricultural employment in 1984 and 1985 is considered to stem from the labour market difficulties that started in 1983. As a result of these movements, overall labour supply was flat from 1965 to 1973, increasing from 1973 to 1981 and declining thereafter.

Labour demand, for its part, is determined primarily by the cost of labour and the level of output, with the latter seeming to have played a decisive role in Portugal. Sluggish labour demand appears to stem both from the downturn in activity and the rise in productivity. Since 1975, productivity growth has been slightly over 3 per cent a year, a high rate compared to that of other OECD countries. Employment responds to slackening activity and adjusts to the lower demand for labour with a three year lag on average.

The impact of labour costs on the demand for labour is hard to gauge. It would, however, seem to be fairly minor in view of the limited scope for substituting capital for labour in the short term. Also non-salary elements of the cost of labour, resulting from institutional rigidities, play a major role in Portugal, masking some of the effects of monetary costs on labour demand. Public sector employment, which has been rising steeply since 1974, is now likely to feel the repercussions of the budgetary restraint measures. Given the high level of unemployment, it nevertheless seems imperative to reduce the public sector deficits in order to lay firm foundations for sustained medium-term growth of activity and to generate the jobs that are needed.

Portugal's entry into the EEC will gradually open up new markets, enable it to benefit from Community funding and facilitate inward foreign investment; but it also places Portugal in competition with its partners whose economies are generally much more developed. For the advantages to outweigh the risks, the Portuguese authorities must not only focus on the short-term management of the macroeconomic variables, they must also tackle the deep-rooted structural problems besetting the economy. Present policy demonstrates the government's concern to adopt just such an approach. ■

Source: OECD

Prospects for Natural Gas...

Natural gas is one of the important alternatives to oil; in the OECD countries it already accounts for about 19 per cent of the area's energy use. A recent study by the International Energy Agency (IEA) looks at the current market for gas and its possible future role.[1]

The oil price increases of 1973-74 and 1979-80 made it economic to bring onstream new sources of gas, despite high development costs, to expand existing markets and open new ones and to develop trade in gas among OECD contries and also with those outside the area.

Lower oil prices will make it less attractive to develop new sources, but it is too early to know how this will affect long-term supply prospects. According to the report, the share of natural gas in total OECD energy demand could remain almost constant, which would, of course, mean growing demand in absolute terms. A greater share of the gas seems likely to be traded internationally, and with the current trend towards relying on more distant sources of supply, the cost of bringing gas on to the market will increase. Additional factors will work in the same direction; namely the high cost of offshore development and the need to drill deeper to find the gas.

Gas should be priced competitively with other fuels, the study concludes; the crucial issue in terms of matching potential supplies to potential demand is what price (at the input to national transmission grids) importers can afford to pay and still be able to sell the contracted quantities of gas in a competitive market.

OECD Europe

At present, indigenous production covers about half of OECD Europe's gas use, with the United Kingdom and the Netherlands the biggest producers for domestic consumption. The Netherlands also exports substantial quantities to France, Germany, Italy and Belgium under long-term contracts which have been extended to run beyond the turn of the century. British production will gradually decline unless smaller, deeper and more complex gas fields in the North Sea can be developed more economically than at present. Algeria and the Soviet Union are also large suppliers of gas to Western Europe.

The report highlights the role of Norway in ensuring future gas supplies for Western Europe. The major gas supply agreement concluded in May between Norway and a consortium of European importers (comprising gas companies in Belgium, France, Germany, Italy and the Netherlands) provides the basis for developing two major Norwegian offshore sources, the Sleipner and Troll fields. It represented a clear choice in favour of maintaining diversified sources of gas, which is also in line with the IEA study's thinking. One estimate values this deal at about NKr. 500 billion ($66 billion) at current exchange rates, which is about equal to the size of Norway's annual Gross National Product and will enable Norway to overtake the Netherlands as Europe's biggest gas supplier early in the next century. The agreement provides for Norway to supply a total of 450 billion cubic metres of gas (about 390 million of tons of oil equivalent) to the European buyers' consortium between now and the year 2020. Prices are reported to be competitive with other fuels.

North America

North America is presently self-sufficient in natural gas. The few U.S. companies that contracted to import modest volumes of liquefied natural gas (LNG) from Algeria have suspended their imports, and imports of gas carried by pipeline from Mexico have also been halted. The only country from which the United States imports at present is Canada, which supplied 25 billion cubic metres in 1985. Canada's producing regions will be able to meet domestic demand in full until well beyond the year 2000, and its exports to the United States could increase, depending on demand in the United States and the balance between supply and demand in Canada. The study notes that further deregulation of the United States gas industry would be likely to increase its responsiveness to changing market conditions but also that greater

1. Natural Gas Prospects, *IEA/OECD, Paris 1986.*

competition, uncertain oil markets and rising supply and transport costs could change the outlook. This is particularly true for long-term developments such as transporting Alaskan gas to the lower 48 states. The study warns that a continuing decline in United States gas production could imply more oil imports, which could have serious implications for world oil markets.

Japan

Japan is expected to have sufficient supplies of gas to cover demand, at least through the mid-1990s, under existing contracts for imported LNG. Demand is expected to continue to grow steadily, and supplies which currently come from a variety of sources (Brunei, Indonesia, Malaysia, Abu Dhabi and Alaska) will be supplemented by gas from off the coast of Australia. The North-West Shelf Project, as it is known, is the second largest industrial project in the history of Australia (after the well-known Snowy Mountains hydroelectric and development scheme of the 1960s). For Japan, it is number eight in a series of projects to provide itself with natural gas, which began as recently as 1969. Indonesia is currently the most important supplier of gas to Japan and is likely to remain so for many years. If the need is there, other new supplies could be forthcoming. Development has been proposed in Qatar, Thailand, the Soviet Union, and the United States as well as in another region of Australia. The Japanese demand for gas is strongly linked to developments in the electricity sector since gas has an important role as a power station fuel.

...and for Steel

World steel consumption and production showed small increases in 1985, but in 1986 there is likely to be virtual stagnation, according to the OECD's most recent annual steel survey.[1]

Total steel *consumption* in the OECD area may show a slightly smaller decline than last year; demand may grow moderately in Western Europe but is likely to decline in North America and Japan. In the developing areas of the world there will probably be sharply reduced overall growth in demand for steel, and in some areas even a decline.

Total crude steel *production* in the OECD area, which declined by 0.6 per cent in 1985, will probably fall by more than 3 per cent in 1986 (see table). Most of this decline is likely to occur in Japan.

1. The Steel Market in 1985 and the Outlook for 1986, *to be published shortly.*

CRUDE STEEL PRODUCTION

	1985		*1986*	
	million tonnes	*% change*	*million tonnes*	*% change*
Total OECD	365.6	−0.6	353.6	−3.3
Rest Western World	84.1	+7.5	89.8	+6.5
Eastern Europe (incl. USSR)	213.8	−0.2	217.2	+1.5
China and North Korea	55.1	+10.5	58.5	+6.0
World	718.6	+1.2	719.1	+0.1

Net steel *exports* from the OECD area to the rest of the world, which increased markedly in 1985, will probably fall back in 1986. There may be a decline in *imports* of some 15 per cent into the United States in 1986, and the U.S. will probably be replaced as the world's largest single import market by China.

The downward trend in *employment* in the OECD steel industry continued last year, with a reduction of about 5.5 per cent or 68,000 jobs. Since 1974 the number of workers has fallen by around 790,000 or 41 per cent. ■

Training French workers to reline ladles for use in steelworks.

Highlights from the OECD Economic Outlook

The fall in oil prices, reductions in interest rates and a better pattern of exchange rates have significantly improved the short-term outlook for both inflation and real growth in the OECD area. Macroeconomic conditions are accordingly more propitious than they have been for some years for dealing decisively with long-standing structural impediments, including barriers to trade. Continuing unacceptably high unemployment in most countries underlines the need for this opportunity to be seized; and the uncertain duration of the new conditions means that action of this kind is urgent.

Sizeable international imbalances continue to cast their shadow over the OECD economy, contributing to frictions and protectionist pressures. Reduction of the imbalances should not be made to lean unduly on exchange rate changes; nor ought it to be brought about by a marked slowdown in the United States. Rather, rapid growth outside the United States ought to play a significant role in bringing about better balance. Promoting such an outcome is a challenge to the recently-revived spirit of international cooperation.

Improved macroeconomic conditions

Economic conditions in the OECD area have changed to an unusual degree over the past six months or so, and very largely for the better:

- The price of oil imports has fallen in dollar terms by some 40 per cent.
- The dollar is down by nearly one-quarter in effective terms from its peak of just over a year ago.
- Interest rates both short-term and long have been declining nearly everywhere.

These developments have significantly improved the near-term prospects for OECD inflation and growth.

The largest change, for the OECD area as a whole, has been the drop in oil prices. The average OECD oil import price (f.o.b.) is estimated to have fallen from $26.50 per barrel in 1985 to the neighbourhood of $15 – the level which, by technical assumption, is incorporated in the projections for the second half of 1986 and throughout 1987. This assumed fall in the oil price lowers the OECD area's net annual import bill by about $65 billion (equivalent to ¾ of a per cent of the area's GNP), and reduces the value of oil produced in the OECD area by some $80 billion. Non-oil commodity prices have also turned out weaker than expected earlier. Altogether, the OECD's terms of trade have improved by the equivalent of between 1 and 1½ per cent of the area's GNP between early 1985 and what is assumed for the second half of this year.

The dollar has depreciated significantly. By late April it had fallen by some 16 per cent in effective terms since the G.5 announcement last September, and by 23 per cent from its peak of just over a year ago, thereby reversing more than two-thirds of its rise from 1980. In effective terms, the Deutschemark has risen by some 6 per cent *vis-à-vis* its trading partners since last September and the yen by 27 per cent.

Recent exchange rate changes, themselves influenced in part by the relative importance of energy production in the different economies, have affected the distribution of the area's terms-of-trade gain among individual OECD countries. For Japan, the gain may be close to 4 per cent of GNP, and for EMS members between 2 and 3½ per cent. For many of these countries, this is the sharpest improvement in the terms of trade since the early 1950s. Countries which are important energy producers, or which have had depreciating currencies, or both, generally fare much less well: the United States and United Kingdom may come out about even on the terms of trade, Canada and Australia may have a loss of 1 to 1½ per cent of GNP, and Norway one of 10 per cent of GNP.

Falling oil and non-oil commodity prices have much improved the immediate outlook for inflation (Table 1). Indeed, average consumer prices for the OECD as a whole fell in both February and March – the first decline in two consecutive months in the twenty-five years for which such calculations have been made. Further favourable effects on inflation can be expected from the reduction in the prices of other fuels and, in due course, from lower wage settlements. OECD inflation which, as measured by the increase of the private consumption deflator, was 4¾ per cent in 1985, is now projected at 3½ per cent for this year and at 3 per cent for 1987. Excluding three small countries which have inflation rates above 20 per cent, the average rate could be down to about 2¼ per cent next year; Japan, Germany, the Netherlands and Switzerland may have a broadly stable price level.

Another welcome development in recent months has been the substantial declines in interest rates which have taken place in nearly all OECD countries. At the short end these have been co-ordinated by the monetary authorities of the major countries, resulting in somewhat easier monetary conditions throughout the area. In many countries the falls in long-term rates, which are generally less susceptible to policy influences, have been even greater than those in short rates. These falls may be due to two favourable underlying developments. First, the prospects for reduction of budget deficits over the rest of the decade have improved, particularly in the United States. Second, the long-awaited consolidation of gains against inflation that appears to be taking place is presumably being reflected in inflation expectations. The margin of long-term rates over current inflation is now narrower than it has been for several years in a number of countries, although it continues to be wide by earlier standards.

The implications of recent events for activity in OECD countries over the next year or two are more difficult to determine than the effects on inflation. The terms-of-trade improvement will accrue to consumers, firms and governments in differing proportions between countries; important influences include exchange rate changes and government policies with respect to the taxation of energy, particularly oil. But energy-producing sectors in OECD countries will suffer; their investment will be cut back, and government revenues from energy production will be reduced. In all, domestic demand in OECD countries might increase by some 3½ per cent this year and perhaps a shade less in 1987. For both years these rates are close to a percentage point higher than projected last autumn. Trade among OECD countries is expected to be correspondingly stronger. Exports to oil-importing countries outside the OECD area should also be strengthened, but this will be more than offset by lower exports to oil producers. The net effect is to raise the level of OECD GNP projected for the middle of 1987 by about a percentage point compared with last autumn's forecasts.

Some less satisfactory features

Employment growth in the OECD area has been running at about 1 per cent over the past year or so, and is projected to pick up to 1¼ per cent this year. The tendency for employment growth in the United States to be appreciably stronger than elsewhere is expected to continue. Nonetheless, the new jobs are being progressively more widely spread: employment is expected to increase in 1986 in all but one of the OECD countries. But with the labour force also growing at similar rates, recorded unemployment is falling in fewer than half the OECD countries; and for the OECD area as a whole the unemployment rate is projected at an unchanged 8¼ per cent (Table 2).

Progress is also expected to be relatively slow in reducing the major current external imbalances among OECD countries, although it should be borne in mind that forecasting uncertainties are particularly great in this area (Table 3). It is almost

1. PRIVATE CONSUMPTION DEFLATORS IN OECD AREA[a]

Percentage changes seasonally adjusted at annual rates

	1984	1985	1986	1987	1985	1986		1987	
					II	I	II	I	II
United States	4.1	3.2	2¾	2½	3.0	2½	2¾	2½	2½
Japan	2.1	2.2	½	0	1.8	¼	–½	0	½
Germany	2.5	2.0	0	¼	0.6	–¼	0	¼	¼
France	7.2	5.5	2¾	2	4.4	2	2½	2	1¾
United Kingdom	4.6	5.4	4	3¾	4.8	4	3	4	4
Italy	11.1	9.4	5½	3½	8.1	5	3½	3½	3¾
Canada	4.0	4.0	3½	2½	3.7	3¾	3¼	2½	2
Total of above countries	4.3	3.7	2½	2	3.2	2¼	2	2	2
Other OECD countries[b]	11.1	10.9	9¼	8¾	10.4	8½	9	8½	8¼
Total OECD	5.3	4.8	3½	3	4.4	3¼	3	3	3
Four major European countries	5.9	5.2	2¾	2¼	4.1	2½	2	2¼	2¼
OECD Europe	7.9	7.3	5	4¾	6.3	4½	4¾	4½	4¾
EEC	6.7	5.8	3½	2¾	4.7	3¼	2¾	2¾	2½
Total OECD *less* the United States	6.3	6.1	4	3½	5.4	3¾	3½	3½	3¾

Other OECD Countries

	1985	1986	1987
Austria	3.5	1½	2
Belgium	5.0	1½	¾
Denmark	4.7	3¼	2
Finland[c]	5.9	3	3¼
Greece	18.9	20½	12½
Iceland[c]	32.5	20½	20
Ireland	5.5	3	1
Luxembourg	4.1	1½	¾
Netherlands	2.3	–¼	½
Norway	6.1	5½	5
Portugal	19.8	13½	10½
Spain[c]	8.3	8	5½
Sweden	7.2	3½	3
Switzerland[c]	3.4	1	½
Turkey	45.5	32	30
Australia	7.5	7¾	6¼
New Zealand[c]	15.2	12½	10¼

a) Aggregates were computed on the basis of 1982 GNP/GDP values expressed in 1982 US dollars.
b) Half-yearly data must be interpreted with care since for eleven of these countries, amounting to over 50 per cent of the total GDP of the smaller countries, half-yearly growth rates were obtained by purely mechanical interpolations.
c) Consumer price index instead of national accounts implicit private consumption deflator.

inevitable that the United States deficit and the Japanese surplus will be massive this year, being swollen by J-curve effects and, in the case of Japan, by lower oil prices. They are projected by the Secretariat to decline only slightly next year, although the United States foreign balance (net exports) in real terms is projected to begin to improve, and those of Germany and Japan are expected to show clear negative swings. In nominal terms, the U.S. deficit might be running at between 2½ and 3 per cent and the Japanese surplus at more than 3½ per cent of their respective GNPs in 1987. The German surplus is projected to shrink to a proportionately greater extent between this year and next, to perhaps 2½ per cent of GNP.

The OECD countries' terms-of-trade gain has much of its counterpart in losses for many developing countries. As regards oil prices, the OPEC countries as a group are sustaining a terms of trade worsening of the same order as the OECD's improvement: about $5 billion on an annual basis for each $1 per barrel decline. The remaining developing countries taken together produce broadly as much oil as they consume, though with a great diversity of national situations. Most of these countries have suffered from the weakness of non-oil commodity prices; but they stand to benefit from reduced interest rates and the lower dollar – and indeed from the improved growth outlook in OECD countries. It has been established from the outset of the debt crisis that the situation needs to be treated case by case. From this perspective, the situation is one where a large number of cases have either improved or not changed much, while a small number have markedly worsened. Among the large debtors, the clear examples of the latter are Mexico, Nigeria and Venezuela. Countries like these are under pressure to trim back their imports quickly. To the extent, however, that they are unwilling or unable quickly to undertake further large cuts in imports, pressures could spill over into more acute debt-servicing problems; these could intensify strains in the banking system, particularly in the United States, where energy-related domestic lending is also significant.

Assessment of the new prospect

In view of the palpable improvement in the conditions for OECD economic growth over the past six months or so, the change in the forecast might seem modest. Indeed, prospective near-term OECD growth, arrived at on the basis of customary forecasting procedures, has tended to be put at around 3 per cent for the past several years. But the achievement of such growth was being increasingly put at risk by strains in the international economy, notably large current account imbalances, and the strong political and protectionist pressures to which the imbalances were giving rise. Recent developments, while not eliminating these tensions, have on balance significantly reduced them. The projections may no longer need to be accompanied by the warning that the risks attaching to them are predominantly on the down side. A warning that *is* in order is that the present OECD economic situation, marked by major changes emanating in large part from events outside the area, is one where larger-than-average forecasting errors are liable to be made. Moreover, the technical assumptions about oil prices and exchange rates could be belied by events: a rebound in oil prices, for example, could put at risk much of the disinflation gain now in train and the improvement in the growth forecast. But if the new conditions stick, and are reinforced by substantially increased confidence, one possibility is for the OECD economy to undergo a change of gear, and move into a period of substantially better performance than envisaged in the projections.

Recent *Economic Outlooks* have seen the "international imbalances" as the source of the greatest risks hanging over the sustainability of expansion in OECD countries. Now that the dollar has fallen by nearly a quarter, but current imbalances are nonetheless expected to remain large for some time, to what extent have those risks been reduced? One important risk stemming from the international imbalances that was perceived at an earlier stage was that protectionist pressures in the United States might become irresistible. The risk here seems now to be smaller, but nonetheless remains a matter of serious concern. Another risk was that a "free fall" of the dollar might force the Federal Reserve to tighten policy abruptly. This has not so far materialised and, while it would be premature to suggest that the risk has been eliminated, it does appear to have been significantly reduced.

Given the uncertainties in the outlook, as well as the likely persistence of unemployment and external imbalances in the OECD area and financial difficulties in the developing world, euphoria engendered by the new economic circumstances would be misplaced. It would be particularly unfortunate if the somewhat better situation – which might turn out to be short-lived – led governments to ease up in their medium-term efforts to improve the structure of OECD economies. The appropriate response is the opposite one: to seek to exploit the opportunity provided by the new situation to step up such efforts. For at a time when the macroeconomic preconditions for expansion are in a number of respects so favourable, the growth rates now in prospect can be considered somewhat disappointing (Table 4). An aggregate OECD growth rate of the order of 3 per cent a year is probably needed to keep unemployment area-wide broadly stable as well as to prevent a deterioration in the financial position of indebted developing countries. It would be desirable for growth over the next few years to be rather faster than that, permitting some inroads to be made into these problems. The challenge to OECD governments is to provide a framework conducive both to such faster growth, while maintaining lower inflation, and to the unwinding of the major current account imbalances.

Macroeconomic policy and interest rates

While there would probably be general agreement about the desirability of faster growth, particularly in countries other than the United States, the way of achieving it is less clear. The previous *Economic Outlook*

2. UNEMPLOYMENT IN THE OECD AREA

National Definitions

	1984	1985	1986	1987	1985	1986		1987	
					II	I	II	I	II
Unemployment rates %									
United States	7.5	7.2	7	6¾	7.1	7	7	6¾	6¾
Japan	2.7	2.6	2¾	3	2.7	2¾	2¾	3	3
Germany	8.2	8.3	8	7¼	8.3	8	7¾	7½	7¼
France	9.9	10.2	10¼	10¼	10.2	10¼	10¼	10¼	10¼
United Kingdom	11.7	11.9	12	11¾	11.9	12	12	11¾	11½
Italy	10.3	10.6	11	11½	10.8	11	11	11¼	11½
Canada	11.3	10.5	9½	9½	10.2	9¾	9½	9½	9½
Total of above countries	7.6	7.5	7½	7¼	7.4	7½	7½	7¼	7¼
Other OECD countries	11.5	11.6	11½	11¾	11.6	11½	11½	11½	11¾
Total OECD	8.4	8.3	8¼	8¼	8.3	8¼	8¼	8¼	8¼
Four major European countries	10.0	10.2	10¼	10	10.3	10¼	10¼	10¼	10
OECD Europe	10.8	11.0	11	11	11.0	11	11	11	11
EEC	11.4	11.6	11½	11½	11.6	11½	11½	11½	11½
Total OECD *less* the United States	8.8	8.9	8¾	8¾	8.9	9	8¾	8¾	8¾
Unemployment levels (millions)									
North America	9.9	9.6	9½	9¼	9.5	9½	9½	9¼	9¼
OECD Europe	18.4	18.9	19	19	19.1	19¼	19	19	19¼
Total OECD	30.6	30.8	31	31	30.8	31	31	30¾	31

Other OECD Countries

	1984	1985	1986	1987
Austria	4.5	5.0	5¼	5¼
Belgium	14.0	13.1	13	12¾
Denmark	10.0	8.9	8½	8¾
Finland	6.2	6.3	6¾	7
Greece	8.0	8.3	8¾	9¼
Iceland	1.3	1.1	1	1
Ireland	15.5	16.8	17¼	17
Luxembourg	1.7	1.6	1½	1½
Netherlands	15.4	14.4	14	14¼
Norway	3.0	2.5	2	2¼
Portugal	10.5	10.2	10¼	9¾
Spain	20.6	21.9	21¾	21¼
Sweden	3.0	2.8	2¾	3
Switzerland	1.1	0.8	½	½
Turkey	12.4	13.1	13½	13¾
Total of above European countries	11.9	12.1	12¼	12¼
Australia	8.9	8.2	7½	7½
New Zealand	3.7	4.1	4¾	5¼
Total of above 17 countries	11.5	11.6	11½	11¾

considered the lessons that should be drawn for the present episode from earlier periods of OECD recovery. It was concluded that, largely because of the cautious stance of monetary policy in most countries over a period of several years, this present recovery, in contrast to many earlier ones, looked unlikely to come to an early end, or to have to be brought to one, because of an outbreak of inflation. The recent round of disinflation, coming at a time when inflation rates had already been declining for over five years, adds strength to that conclusion. By the same token, earlier experience would suggest that macroeconomic policy can best contribute to sustaining expansion by maintaining a steady overall stance.

Interest rates are key. Despite substantial falls in rates in recent months, on most measures they still remain higher in relation to inflation than at most times in the post-war period. Further reductions would be welcome to the extent they did not jeopardise monetary control or inflation objectives. Both fiscal and monetary policy have a role to play in promoting interest rate declines; indeed, the success already achieved in bringing rates down is in part an indication that the mix between the two policies is becoming better balanced than it was a few years ago.

An important contribution to lowering interest rates both in the United States and abroad would be a progressive reduction of the U.S. fiscal deficit of the magnitude, at least for the first few years, suggested by the Gramm-Rudman-Hollings Act. The outlook for the U.S. budget deficit seems anyway to have improved recently, perhaps significantly, as a result of assumed lower interest rates and revised assessments of Federal spending. This improvement would have been reinforced by the even more rapid recent declines in both short and long-term interest rates. Moreover, when – as is likely – the Gramm-Rudman-Hollings Act becomes effective, there may be a further fall in long-term rates. The precise implications of the Act may, however, remain difficult to determine for some time.

As regards fiscal policy outside the United States, it is often suggested that as the United States budget deficit is reduced, other countries should "offset" the likely deflationary effect on world demand by allowing some easing of their fiscal policy. That effect is for the moment still uncertain in size and timing, though the OECD Secretariat's projections of course include an allowance for U.S. deficit reduction, particularly in 1987. But in any case, if it is thought that fiscal policy outside the United States can appropriately play a demand-stabilizing role, its use should be decided upon in relation to the macroeconomic situation as a whole, rather than to the possible deflationary impact of any single factor. From this perspective, the projections do not point to a need for general fiscal expansion.

Moreover, in practice, not many countries could envisage the active use of fiscal policy in this way. Over recent years, governments have become particularly concerned about the growth of public debt. Many have reached the conclusion that ratios of debt to GNP are too high (and in most countries they are still rising), and that it is necessary to begin to reduce them. While no rigorous way has been found of determining an "optimal" debt-to-GNP ratio, there is perhaps a presumption that in extended "calm" periods, of the kind it is hoped the OECD economy is now entering, the ratio should be stable or, preferably, falling.

Both Germany and Japan have made considerable efforts of consolidation at the level of general government and have broadly stabilised the debt-to-GNP ratio. It would accordingly seem reasonable for the time being to envisage for these countries continuation of a stable, or perhaps slightly falling, debt-to-GNP ratio, which according to Secretariat estimates would go along with broadly unchanged structural deficits in relation to GNP; this indeed is what is implied by Germany's announced intentions for the medium term. In the longer run, the growth in the retired population in Japan and Germany and the concomitant rise in public pension costs will require further budgetary consolidation. If, however, domestic demand in these countries and demand area-wide turned out significantly weaker than expected, it would seem possible for them temporarily to delay their consolidation efforts.

For most other countries, budget deficits need to be reduced significantly. This is particularly urgent in Italy, Greece, Ireland, Turkey, Portugal and Belgium, but it is important also in Canada, Spain, the Netherlands and Iceland. In many of these countries, indeed, measures to this effect are being put in place.

Taken in conjunction with policies on the budgetary side, the appropriate conduct of monetary policy would appear to offer the means of achieving in due course further reductions of interest rates, given the OECD-wide disinflation that is now in train. Central banks have been applying policy pragmatically, with monetary aggregates being allowed to grow close to the upper ends of target ranges, or even overshooting them when other indicators suggested that such a course was consistent with objectives for inflation. To the extent that inflation falls, and is expected to remain at lower rates, adherence to unchanged monetary policy interpreted in this way should be conducive to further lowering of interest rates.

Within a prospect of lower interest rates at the level of the OECD economy as a whole, the scope for reduction is likely to differ significantly between countries. Countries with a tendency towards currency appreciation are likely to experience the strongest downward pressure on interest rates, and greater scope to accommodate such pressure, while those with the reverse tendency might see little downward pressure. A complicating factor here is that major countries' attitudes

3. CURRENT BALANCES OF OECD COUNTRIES

$ billion; seasonally adjusted at annual rates

	1984	1985	1986	1987	1985	1986		1987	
					II	I	II	I	II
United States	–107.4	–117.7	–132	–124¾	–131.7	–136	–128	–126½	–123
Japan	35.0	49.3	76½	70¾	55.1	74	79	73½	68
Germany	6.3	13.1	28½	21¾	17.1	29¼	27¾	23	20¼
France	–0.8	0.3	7½	5½	1.3	7¾	7½	6	5
United Kingdom	1.2	3.8	4	–¾	5.3	6¾	1¼	¼	–2
Italy	–3.0	–4.1	4	3¼	0.6	2¾	5½	4	2¾
Canada	2.0	–1.9	–5¼	–3	–4.2	–5½	–5¼	–3¾	–2¼
Total of above countries	–66.7	–57.1	–16½	–27½	–56.5	–21	–12¼	–23½	–31½
Other OECD countries	–2.4	–2.1	8½	5	0.1	8¼	8½	5¼	4¾
Total OECD	–69.0	–59.2	–8¼	–22½	–56.4	–12¾	–3¾	–18¼	–26¾
Four major European countries	3.7	13.2	44¼	29¾	24.3	46½	42	33¼	26
OECD Europe	11.3	20.7	61	41¾	35.1	64	58	45¾	37¾
EEC	5.6	16.0	57¼	41	27.8	59¼	55½	45	37
Total OECD *less* the United States	38.3	58.4	123¾	102¼	75.3	123¼	124¼	108¼	96¼

Other OECD Countries

	1984	1985	1986	1987
Austria	–0.2	–0.1	½	0
Belgium-Luxembourg	0	0.1	3¼	3½
Denmark	–1.6	–2.6	–2½	–1¾
Finland	0	–0.6	–½	–¾
Greece	–2.1	–3.3	–1½	–1¼
Iceland	–0.1	–0.1	0	0
Ireland	–0.9	–0.6	–½	–½
Netherlands	4.8	5.9	8½	7½
Norway	3.2	3.0	–3	–4¾
Portugal	–0.6	0.3	½	0
Spain	2.4	3.0	5	3¾
Sweden	0.4	–0.8	¾	1¼
Switzerland	3.8	4.5	7	5¾
Turkey	–1.4	–1.0	–¾	–1
Total of above European countries	7.6	7.5	16¾	12
Australia	–8.4	–8.6	–8	–6½
New Zealand	–1.6	–1.1	–½	–½
Total of above 17 countries	–2.4	–2.1	8½	5

with respect to exchange rate levels are now subject to conflicting considerations. On the one hand, unless relative evolutions of domestic demand in the United States and abroad are such as to provoke more adjustment than currently appears likely, restoration of sustainable current account positions over the medium term could well call at some stage for a lower value for the dollar than that embodied in the projections. On the other hand, the fortuitous timing of the decline in oil prices that accompanied the recent decline in the dollar is not something that can be expected to be repeated. Without such an offset, dollar depreciation would be visibly reflected in United States inflation; this would argue for seeking to avoid an over-rapid fall. Equivalently, rapid deterioration in the situation of exporting sectors in appreciating countries has also led some to argue for the desirability of a "pause" in exchange rate movements. Even if such a pause were generally thought appropriate in itself, however, there would still be major questions as to what policies might be effective in achieving it and whether they would be appropriate as seen from a broader perspective.

Responding to the decline in oil prices

One immediate policy issue to have faced all OECD governments in recent months has been how to respond to the oil price fall. There is a widely-shared presumption that, where possible, it is desirable for the lower prices to be passed through fully to final users, thereby maximising the beneficial effects on growth and inflation. This has been the approach adopted in the three largest countries and a few others. A good number of countries, however, have either raised taxes on energy products or envisage doing so. To a considerable extent, these increases have served to maintain revenues realised by *ad valorem* taxes; where proceeds have been increased they are for the most part being used to lower budget deficits rather than to lower other taxes. This would suggest that such moves can be thought of as being as much measures of fiscal policy as of energy policy.

The distribution of the "oil bonus" in oil-importing countries is of course also affected by the way wage and price formation work themselves out. This depends largely on decisions in the private sector. Public authorities have only a limited direct impact on the outcome; they do, however, have a responsibility for ensuring that the process is informed by correct economic analysis. A commonly-heard argument, particularly in countries where real wage increases have moderated substantially over the past few years, is that because it is now appropriate for labour to enjoy a substantial part of the terms-of-trade gain, wage increases need not decline in line with the current reduction of inflation rates. What this line of thought misses is the fact that there is at present a rare opportunity to convert a favourable shock to the price level into a ratcheting-down of the rate of inflation by continuing to promote nominal wage moderation: a rise in real wages can still occur, but with lower rates of increase of both nominal wages and prices. This opportunity should be exploited as actively as possible, in order to embed the current disinflation gains in inflation expectations and thereby to improve the prospects for further falls in long-term interest rates, and non-inflationary expansion of real output and employment.

Speeding up structural adjustment

There is much that policies on the structural side can do, within a framework provided by appropriate monetary and fiscal policy settings, to foster more rapid sustained growth. Such policies were discussed in some detail in the previous issue of the *Economic Outlook*. The pace of structural change in many countries remains insufficient in the face of the challenges posed by new technologies, evolving markets, and emerging patterns of comparative advantage. There is a continuing need to promote efficiency and productivity through improved incentives and a better allocation of resources; to foster greater flexibility; to ease the process of adjustment; and to reduce the inflation risks that might otherwise be associated with higher levels of employment and capacity utilisation. In some areas significant progress has been made in recent years: this generalisation applies to public finances, labour markets, domestic systems of regulation, and financial markets, both internal and international. Such policies have perhaps been pursued with most vigour in recent years in the United States, the need having been somewhat less pressing in Japan, at least in the manufacturing sector. In Europe there is less evidence as yet of willingness to tackle entrenched interest groups on structural reform in traditionally regulated sectors such as transport, telecommunications and insurance.

In the case of *agriculture*, structural adjustment has been taking place, but not at a rate sufficient to prevent the persistent and widespread production of surpluses. This situation, due in particular to the policies that have been followed by practically all OECD countries, has entailed increasing budgetary strains and trade distortions. The cumulative effects of inadequate adjustment constitute a threat to the open multilateral trading system.

The area of *trade policies* more generally is of central importance. Over the past fifteen years or so, there has been increasing resort to forms of trade interventionism that diminish the scope and effectiveness of markets. The effects are to raise costs and prices; to slow down the adjustment process; to penalise the industries and sectors that are unable to obtain special favours; to protect labour and product markets from the need to respond to change; and to encourage reliance on successful lobbying rather than good performance. At the same time, world markets themselves have been made narrower and more unstable. In all these ways, trade interventionism runs directly counter to what governments are trying to achieve through other structural policies.

Although intervention has increased in recent years, in part because of an unfavourable economic environment, governments have avoided resort to the most damaging forms of protectionism. Moreover, some

4. GROWTH OF REAL GDP/GNP IN THE OECD AREA[a]

Percentage changes seasonally adjusted at annual rates

	1982 Share in total OECD	From previous year				From previous half year				
		1984	1985	1986	1987	1985	1986		1987	
						II	I	II	I	II
United States	41.1	6.6	2.2	3	3¾	1.9	3¼	3¾	3¾	3¾
Japan	14.2	5.1	4.6	3¼	3	4.7	2¾	2¾	3	3½
Germany	8.0	3.0	2.4	3½	3	5.0	2½	3½	3	2¾
France	7.0	1.5	1.2	2½	2½	3.1	2¼	2¾	2½	2¼
United Kingdom	6.3	2.8	3.2	3	2¼	2.2	3½	2¼	2¼	2¼
Italy	4.5	2.8	2.3	2¾	2¾	2.5	3	3¼	2¾	2½
Canada	3.8	5.0	4.5	3¾	3¼	5.6	3¼	3	3	3¼
Total of above countries	85.0	5.1	2.7	3	3¼	3.0	3	3¼	3¼	3¼
Other OECD countries[b]	15.0	3.3	2.9	2½	2¼	3.1	2½	2½	2¼	2
Total OECD	100.0	4.8	2.8	3	3¼	3.0	3	3¼	3¼	3¼
Four major European countries	25.8	2.5	2.3	3	2¾	3.4	2¾	3	2¾	2½
Total OECD *less* the United States	58.9	3.5	3.2	3	2¾	3.8	2¾	2¾	2¾	2¾
Industrial Production:										
Major seven countries	–	8.9	2.9	2¼	3¼	2.2	2	3¼	3¼	3¼
Total OECD	–	8.4	3.0	2½	3¼	2.3	2¼	3¼	3¼	3¼

Other OECD Countries

Percentage changes

	1982 Share in total OECD	From previous year			
		1984	1985	1986	1987
Austria	0.9	2.0	2.9	2¾	2
Belgium	1.1	1.3	1.1	1¾	1½
Denmark	0.7	3.5	3.1	2½	2½
Finland	0.7	3.0	2.8	1½	1½
Greece	0.5	2.6	1.7	0	0
Iceland	0	2.5	2.8	3	2¼
Ireland	0.2	2.3	–0.7	3	4
Luxembourg	0	4.9	1.9	2	2¼
Netherlands	1.8	1.8	2.0	1½	¾
Norway	0.7	5.6	4.4	4¼	2¼
Portugal	0.3	–1.5	2.8	3¾	3¾
Spain	2.4	2.2	2.1	3	3
Sweden	1.3	3.4	2.3	2	1¾
Switzerland	1.3	2.1	3.8	2¾	2
Turkey	0.7	5.9	4.9	4¾	5
Total of above European countries	12.6	2.6	2.6	2½	2¼
Australia	2.1	6.8	4.7	3½	3½
New Zealand	0.3	4.8	0.8	–1	0
Total of above 17 countries	15.0	3.3	2.9	2½	2¼
OECD Europe	38.5	2.6	2.4	2¾	2½
EEC	32.9	2.4	2.2	2¾	2½

a) Aggregates were computed on the basis of 1982 exchange rates.
b) Half-yearly data must be interpreted with care since for eleven of these countries, amounting to over 50 per cent of the total GDP of the smaller countries, half-yearly growth rates were obtained by a purely mechanical interpolation.

results, admittedly modest, have been achieved by recent efforts progressively to relax and dismantle protective measures. Further actions, both general and specific, are called for. At the general level, there is a need to reaffirm more explicitly the principles on which the present multilateral trading system rests, including in particular the principle of non-discrimination: much of current trade policy is associated with an inappropriate concern with bilateral trade balances, which leads in turn to a search for bilateral solutions. But it is necessary to go beyond statements of principle, and to give them practical effect. Here, the prospective new round of multilateral trade negotiations within the GATT is essential as it will provide a major opportunity for strengthening the system, and for agreed reductions in trade barriers. In line with OECD countries' recently expressed political commitments, these negotiations need to be supported by an effective standstill on restrictive actions. In addition, it should be possible – and would also be in line with those commitments – to find ways and means to reduce trade-restrictive and trade-distorting measures without awaiting the final outcome of the new round of trade negotiations, and without prejudice to it.

Increasing *labour market* flexibility continues to be important both to reduce unemployment and to foster sustainable growth. As prospects for expansion improve, greater attention may need to be paid to the adequacy of the human capital base. This is a matter in part of specific skills to facilitate occupational adaptation and limit mismatch unemployment, thereby avoiding price pressure arising from production bottlenecks; and in part of high quality basic education essential to the flexibility of the labour force and to underpin growth in the medium term. Price signals coming from labour markets should provide appropriate incentives to skill formation; it may be important for the compression of earnings differentials by skill level and experience to be reversed.

The need for faster employment growth is particularly pressing in Europe. Faster output growth would contribute to this, but a comparison of U.S. and European employment trends since the early 1970s suggests that a number of other elements are also involved. One feature that stands out is the key role that employment growth in the service sector has played in shaping overall employment trends, with those countries where wage differentials (in terms of levels and/or rates of change) between manufacturing and services are largest, generally achieving the strongest overall employment growth. Another feature is the balance between cost-cutting investment, which is often associated with declining employment possibilities in the sector involved, and investments directed at increasing capacity – or creating capacity to produce new products or services – which entail complementary increases in employment. These considerations, together with generally improved profitability (due to wage moderation and shake-out of unprofitable labour), suggest the importance for policy of looking beyond the labour market as such in considering action to promote stronger employment growth – though obviously labour-market functioning is central. Regulatory policies, capital market policies, trade policies, and tax/subsidy policies are all important factors affecting inter-sectoral shifts in the composition of production, and in influencing the level and type of investment undertaken by firms.

Over the past five years or so, real labour cost growth has moderated significantly, with the notable exception of the United Kingdom. There has been a major recovery of profit margins and returns to productive investment. In a few countries, tax/subsidy programmes have also become less biased towards investment. It is thus less clear today whether significant further shifts in relative cost/price relationships are a necessary component in creating stronger employment growth. With continuing wage moderation, stronger employment growth may be achievable with a given rate of output growth than earlier. The relatively weak response of employment thus far to moderating costs has probably been a reflection primarily of the fact that adjustment processes in this domain work slowly. Given the uncertainties in this area, the precise path of real labour costs that would be consistent with achieving any specified rate of employment growth cannot be prescribed. Nevertheless, other things being equal, a more moderate path would be consistent with stronger employment performance.

Reducing international imbalances

The reduction of the *United States*' budget deficit for which a framework is now in place has been recognised for a long time as an important element in unwinding the international imbalances. Success here would in itself help bring down the current external deficit. The recent depreciation of the dollar is also contributing to lowering the current external deficit, compared with what it would otherwise have been. That qualification is important, however, because there are two powerful forces at work tending to widen the external deficit:

- The United States having had a stronger recovery than the rest of the OECD area, and U.S. imports now standing, for this and other reasons, over 50 per cent higher than exports, the deficit automatically tends to widen steadily in absolute terms if domestic demand grows at broadly the same rate in the rest of the OECD as in the United States
- The apparent net foreign asset position of the United States has worsened by nearly

$300 billion over the past four years, and even on more optimistic projections than the OECD's the worsening over the six years to end-1987 is set to amount to at least $500 billion. This reduces the annual net receipts of investment income by perhaps between $35 and $50 billion. The longer it takes for the deficit to be decisively brought down, the stronger will be the tendency, on this account, for it to become larger still.

The surest way to reduce a current external deficit, and the one almost invariably chosen when a country is forced to adjust quickly, is to reduce the growth of domestic demand. Reduction of the U.S. budget deficit would tend to have such an effect in the short run. To go further than this in weakening domestic demand would be costly, both for the United States and the world economy, at a time when there was no need on domestic grounds for slower demand growth. More desirable routes towards a more sustainable configuration of international balances would be based, in addition to cutting the U.S. budget deficit, on some combination of:

- further progressive dollar depreciation, not least *vis-à-vis* some of the most competitive non-OECD countries including those in South East Asia, at a rate that could be absorbed without a significant pick-up of U.S. domestic price and wage increases
- lower interest rates worldwide, serving to moderate the cumulative "stock" effects that occur when persistent non-interest government or current account deficits interact with interest rates that exceed growth rates; and
- faster growth of domestic demand and imports outside the United States.

The marked appreciation of the yen will help reduce the *Japanese* current external surplus once the adverse J-curve effects have worked through. But the stronger yen – despite its positive income effects stemming from the change in the terms of trade – will also exert a deflationary impact on GNP through reduced net export volumes. Indeed the Secretariat's projections suggest that GNP growth will fall well below potential, unless stronger growth of domestic demand takes over more of the running. Lower oil prices and recent reductions in interest rates should help in this regard. Fiscal policy could also contribute to mitigating the near-term deflationary impact of yen appreciation to the extent that successes in recent years in reducing budget deficits have increased fiscal flexibility; and recent action to promote infrastructure investment through local government bond issues and the more active use of government loan accounts go some way in this direction. Over the longer term, changes in the structure of the Japanese economy, along the lines recommended in the recent Maekawa report, would contribute to a reduced current external surplus; and demographic changes may work in the same direction, as the maturation of the pension system entails a shift in the social security system towards deficits – thus absorbing domestic savings instead of adding to them. The Japanese tax system could appropriately be made more neutral with respect to personal savings; the resulting higher revenue could enable a reduction of income tax.

Interest Rate Changes

	1984	*1985*	*1986*	*1987*	*1985*	*1986*		*1987*	
					II	*I*	*II*	*I*	*II*
Short term rates									
United States	9.52	7.48	6.10	5.50	7.14	6.37	5.83	5.50	5.50
Japan	6.07	6.47	4.60	3.75	6.77	5.20	4.00	3.80	3.70
Germany	5.99	5.44	3.96	3.71	4.88	4.20	3.71	3.81	3.61
France	11.74	9.94	7.25	5.60	9.42	8.00	6.50	6.00	5.20
United Kingdom	9.30	11.56	10.25	8.75	11.14	11.00	9.50	9.00	8.50
Italy	17.26	15.26	11.50	8.25	14.69	12.50	10.50	9.00	7.50
Canada	11.19	9.56	8.91	6.50	9.03	9.83	8.00	7.00	6.00
Long term rates									
United States	12.71	11.37	8.78	8.00	10.80	9.05	8.50	8.00	8.00
Japan	7.08	6.78	5.60	4.75	6.63	6.00	5.20	4.80	4.70
Germany	7.79	6.94	5.64	5.24	6.60	5.98	5.30	5.29	5.19
France	13.41	11.87	8.60	7.25	11.66	9.20	8.00	7.50	7.00
United Kingdom	10.69	10.62	10.60	9.55	10.38	10.90	10.30	9.80	9.30
Italy	15.09	13.12	10.50	8.50	13.24	12.00	9.00	8.70	8.30
Canada	12.75	11.04	9.71	8.40	10.63	10.23	9.20	8.80	8.00

For the first time OECD's Economic Outlook has made projections of interest rates.

Finally, Japanese overseas direct investment could be encouraged so that production abroad would reduce exports and increase imports and expedite Japan's participation in intra-industry foreign trade.

In discussing the present international imbalances, it is natural for the emphasis to be on the United States and Japan. But restoration of a sustainable pattern of current accounts will necessarily involve other countries too. *Germany* is projected to have a surplus of close to $30 billion this year and seven other European countries between them to have a combined surplus of $40 billion; in the *Netherlands* and *Switzerland* the surplus may be larger in relation to GNP than Japan's. It is appropriate for domestic demand in a number of these countries, particularly those where virtual price stability is expected, to expand sufficiently rapidly to ensure that output growth is at least in line with that of productive potential.

As regards the other major international imbalance, *developing country debt*, the framework adopted four years ago and refined recently along the lines of the U.S. proposals remains the appropriate one. Improved performance of the OECD economies is fundamental to the continuing implementation of that debt strategy, as is access to open markets in OECD countries. But the most important single element in the strategy is the pursuit by the indebted countries themselves of sound policies, both macroeconomic and structural, backed as appropriate by IMF and/or World Bank programmes and by coordinated financial support from both official and private creditors. In the latter connection, the authorities in OECD countries have a responsibility to promote the appropriate scale of financial flows, bearing in mind *inter alia* the recent worsening of the developing countries' terms of trade.

Need for intensified international cooperation

The improved prospects for sustained growth are attributable in no small part to the cooperative policy moves taken internationally over the past year. The April 1986 meeting of the OECD Council at Ministerial level, and other recent high-level international meetings, have reaffirmed and strengthened the commitment to cooperative action. This is much to be welcomed, because the maintenance of a satisfactory rate of growth area-wide at low inflation rates while unwinding the international imbalances undoubtedly requires such an approach – quite apart from issues such as trade policy and developing country debt which by their very nature call for international agreement. Sound domestic policies, both macro and structural, in each individual country are a *sine qua non*; but continuing close cooperation, including multilateral surveillance, is a necessary complement.

These issues occupy an important place in the Tokyo Economic Declaration. Major countries have emphasised the importance of surveillance, are exploring the most effective way of organising it, and seeking to put it on as objective a footing as possible. They have agreed to base it in part upon a set of "indicators" of each country's economic policies and performance, complemented by an important element of judgement. This process also requires analysis of the way the major countries' situations interact with each other and with those of the other OECD countries and the rest of the world economy. Such analysis needs to pay considerable attention not only to the evolution and determinants of exchange rates, but also to a range of other indications of compatibility or of strain between different countries' policy settings.

The object of multilateral surveillance should in general be to enable countries collectively to forestall the emergence of major imbalances; it should at the same time serve to reduce wide swings in exchange rates. In the present situation, surveillance has as its main requirement to deal with existing imbalances. Assessment here may become increasingly difficult. September's G.5 announcement on exchange rates, and

recent coordinated reductions in interest rates, each came at a time when there was an overwhelming consensus on the needed direction of change, and when official desires were consonant with market pressures. As the more extreme imbalances and incompatibilities of policy settings are corrected, such a consensus may be harder to establish. Required policy adjustments, or exchange market intervention, in the future might well be more subtle and differentiated.

The task of unwinding present international imbalances without derailing the recovery of the world economy is a particularly apt example of the need not only for cooperation among countries at the policy-making level but also for such cooperation to be backed by impartial and widely-shared analysis of international linkages.

16th May, 1986

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