

# the OECD OBSERVER

31 Million Reasons to Fight Unemployment  
Life Insurance and the Consumer  
Product Safety  
Economic Outlook  
Making the Cities More Liveable



Paris as seen from SPOT satellite

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# the OECD OBSERVER

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# OECD: Analyst and Catalyst

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*OECD has just celebrated its 25th year. Jean-Claude Paye, Secretary-General of the Organisation, shares his thoughts on this occasion with readers of the OECD Observer.*



*What, in your opinion, are OECD's most important achievements in the last 25 years?*

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## ACCOMPLISHMENTS

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The question is both a difficult and an easy one. OECD, which was set up as a body for intergovernmental cooperation, has such a broad range of activities that it is difficult to point to one or two particular achievements. Cooperation covers a very wide gamut which is becoming even wider. In general terms, it can be said that, in the last 25 years, OECD has fulfilled its mission well by successfully helping to strengthen and diversify cooperation among its Member countries. One of the characteristics of this Organisation is that, as a result of the interaction and feedback between its many committees and a secretariat of high quality, it has constantly been able to identify, analyse and thus help to solve new problems as they appear. I shall give you a few examples:

**Economic policy.** We have moved from a period when we thought the economy could be fine-tuned through the use of two main instruments – monetary policy and fiscal policy – to one in which we have realized that these instruments are not in themselves sufficient, or are not working very well, or at least are difficult to handle in a changed world, in which, for example, there are floating exchange rates. Increasing importance is therefore attached to the improvement of economic structures. OECD was among the first to adopt this new approach. Of course, all the ideas did not originate within OECD, but it was their focal point. For a number of years, the Organisation has been examining structural adjustment, which is now recognized as being a requisite for a sound economy.

**Employment problems.** Most OECD countries at present suffer from abnormally high unemployment, despite economic growth that is far from negligible. The amount of analysis and discussion being devoted to this problem within OECD reflects the seriousness of the problem and will certainly help in its solution.

**North-South interdependence.** Here again we do not have a monopoly, but I think that OECD has usefully contributed to establishing the full extent of that interdependence. It has studied its effects and is in the process of showing that, in today's world, we must be concerned not only with the economic policies of OECD countries but also with the evolution of the developing countries, which are an increasingly important force in the world economic system. In other words, we are moving from a mainly trilateral world economy – the United States, Europe and Japan – to a plurilateral and multipolar economy.

**The Environment.** In this area too, OECD helped to clear the way and, if I am not mistaken, played a pioneering role. The impact of technology on our economies and new patterns of migration are also areas which will be of growing importance in the future.

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*Has OECD achieved the aims set by its Convention?*

*The target of full employment is often cited as one that has not been achieved...*

*What is your reaction when OECD is described as "the rich man's club"?*

*How has OECD adjusted to the upheavals of the last 25 years?*

*For its 25th anniversary, OECD invited 30 or so eminent theoreticians and practitioners of economic policy from Member countries and from the Third World to look into the subject of "opportunities and risks for the world economy: the challenge of increasing complexity", with four major topics as the focal points of discussion: fundamental trends and the forces of change; the effectiveness of national policies in an interdependent world; the role of new technologies in our changing societies; action by the authorities in response to change and the effects on international cooperation. Why this particular formula?*

So it is difficult to identify a single or even several accomplishments since, over the 25 years, OECD has initiated or acted as a catalyst in every aspect of its activities.

Yes and no. These aims are, in fact, moving targets. In terms of a rising standard of living, expansion of trade and progress in the developing countries, there certainly has been progress, though probably it could no doubt have been more rapid.

It is true that we have not achieved full employment. We are even further from it than we were in the 1960s. And that is serious, especially for young people, who feel rejected by the society, and for the long-term unemployed. Yet, I am convinced that we will come closer to full employment again, but it will no longer be full employment in the sense of 25 years ago. It will be another kind, based on types of activity that are just emerging. I think we are now marking time because neither our ways of thinking nor our societies have adjusted to the new kinds of jobs, and these will have little in common with production line jobs in a traditional factory.

As in every catch phrase, there is some truth in it, but it does not give the full picture. If it really were a club for the rich, it would have to include a number of countries with a higher per capita income than that of some OECD countries. No, it is not a rich man's club. I think the expression is no longer justified, but it certainly is a developed countries' club, because OECD brings together all the countries with a similar experience – industrial development – and a similar set of economic and political values, those of a democracy oriented towards a market economy.

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## ADAPTATION

The first upheaval was, I think, **the change in the international monetary system**: the Bretton Woods system, with its advantages and drawbacks, or at any rate with the kinds of discipline it imposed, was abandoned at the start of the 1970s. How did OECD adjust to this new situation, in view of the fact that it had played an important role in steering economic policies in compliance with this discipline? As I said earlier, it stressed the need to supplement macro-economic control with firm action to improve economic structures and micro-economic policies, as well as with a greater effort to achieve compatibility and complementarity in the economic policies conducted by Member countries.

A second upheaval was caused by the **oil-price shocks**. OECD's role was important on two counts: first, defining and implementing the economic policy adjustments necessary to absorb these major policy disruptions with as little damage as possible. Second, in strengthening cooperation on energy policy, with the creation of the International Energy Agency.

The third upheaval has been a **technological one**. It is clear that at least one kind of technology – information technology – is a revolutionary development that is affecting every part of the economy and practically every human activity. We are making a major effort – in terms of both finances and human resources – to study this development.

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## SALIENT POINTS FROM A SYMPOSIUM

A symposium bringing together eminent personalities from many countries and several sectors of economic, social and political life seemed to me the best way of coming to grips with the in-depth changes now occurring in the economy and in the society.

The world is now and is increasingly becoming interdependent. This interdependence can be seen not only in the role played by international trade in the economies of individual countries, but also in the increase in travel, the dissemination of information, the size of multinational firms with their global strategies, and the development of interlinked world financial markets which have sprung up, working round the clock and turning over hundreds of billions of dollars. Ours is a world that has become more and more interactive. But at the same time, it seems that our collective ability to run this world has not kept pace and that there is a certain lack of synchronization. Hence the importance of trying to understand exactly what is going on.

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*What are the main points that emerged from the symposium?*

A great many – some on matters of detail but also some important departures. At the risk of speaking in generalities, I shall limit myself to the essentials.

- **Point one**, interdependence. It must be analysed in greater depth and its various components identified because some go much deeper than those I have mentioned and are far less evident. It has become obvious that, in an interdependent world, national economic policies must be backed up by genuine international cooperation if they are to be effective.

- **A second point** that struck me: the word “uncertainty” kept coming back like a leitmotiv in the discussions: uncertainty about political events and about economic and social trends in the contemporary world.

- **The third point** follows on from the preceding one: governments must take on, as a priority, the role of reducing uncertainty, which inhibits creative initiatives, both economic and social. By the same token, governments must play a less direct role in economic life than in the past but a greater role as a source of stability. We are coming back, as it were, to the original concept of the role of the state: providing security, setting the rules of the game so that they are clear, fair, enforced and observed. The same holds true at international level where the rules of the game are also a means of reducing uncertainty. There is much to be done in this respect, because greater interdependence has not been matched by the development of cooperation, and, over the years, we have seen the rules of the game circumvented, disregarded, even flaunted, especially, but not exclusively, in the field of trade.

- **Point four**: the profound changes that have taken place in society – new forms of work, the allocation of time between work and leisure, the importance of educational systems and their capacity to prepare people, and not only young people, to accept the rapidity of change, adjust to it and benefit from it.

- **Finally**, the difficulty of reconciling solidarity and vulnerability was, it seems to me, an underlying concern in many of the discussions. Take the example of the financial and banking system. Within a few years, practices have developed that have done away with frontiers, not only between countries, but also between types of financial activity. It is a strength in that it makes it possible to pool financial resources, to keep them moving, to use them as efficiently as possible. But it is also a weakness, for the system may be rocked or even brought down in the event of serious difficulties.

The same applies to what is happening to employment within our countries. The solidarity provided by social welfare between those who have a job and those who do not is a strength. But this has limits and hence a certain vulnerability. If too much is expected of this solidarity, it may well come undone.

Similarly, the expansion and diversification of international trade and the world’s multipolarization are marked both by solidarity and vulnerability. What is happening is that a system which has become highly interdependent – a form of solidarity – is opposed by those who fear detrimental effects and who tend to react by resorting to protectionism.

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## THE NEXT 25 YEARS

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*In this changing world, what will be OECD’s role in, say, the next 25 years?*

I do not pretend to be a prophet. At any time, unforeseeable accidents may completely alter the picture. Economic activity may very well undergo radical change in the coming years, as a result of, say, information technology and biotechnology. Unforeseeable political upheavals may also transform the world economic scene.

- I should prefer to look at the role OECD will have to play whatever happens. The first aspect of this role is not spectacular, but it is the basis of everything else: **constantly improving the collection of, and search for, information**. This is also one of the lessons to be learnt from the symposium: we do not have enough information – in the services sector for example, but in other fields too. Many phenomena can be measured only partially or not at all but they are nevertheless very important for the economic, financial and social life of our countries. Activities are developing in sectors which are not at present quantified – because it is not part of the traditional economic picture – even though it has a bearing on the economy and has economic utility: for example, everything that now comes under the heading, “leisure activities”. The same is true of informal groupings of people into clubs, associations etc.

This lack of information is even felt in certain "traditional" sectors. I have just mentioned the financial activities that have expanded with extreme rapidity. Statistical coverage of such transactions is poor. The importance, for example, of "errors and omissions" in the balance of payments – almost \$100 billion in all – shows that there are gaps in our knowledge. The IMF is coming to the end of a two-year study, in which OECD is actively cooperating, on the reasons for this phenomenon. The study does not reach very precise conclusions but simply suggests that these errors and omissions are more or less evenly distributed among countries according to their share in world trade. But, this is hardly a satisfactory answer.

- Collecting facts is all very well, but the next step – trying to *explain* them – is no less essential. I am sure that in the years to come, perhaps more than in the past, a major effort of analysis and conceptualization will have to be made.

A few examples. Several speakers said during the symposium that "the *models* available do not give a sufficiently accurate and reliable picture of how our economies work". These models should not be abandoned, of course, but they have to be improved and supplemented, and I am referring not only to econometric models but also to the whole of economic theory in its broadest sense. There are no longer any wise men to turn to, or else there are too many. Marx, Keynes, Friedman, Laffer, etc. all have their faithful followers, but we know that none of them has all the answers.

**The functioning of the international economy** is another area in which the search continues, and much still needs to be explained: financial markets and the impact of multinational firms, for example, are not new, but they have taken on a new dimension as a result of information technologies and greater international competition, coupled with more obstacles to this competition.

But in-depth analysis is also needed on what I just referred to as **the transition from the trilateral to the plurilateral world**. In our studies of the economic situation and prospects at OECD, we have to attach more importance to what is going on in the rest of the world. This is part of the shift in relative weight of OECD countries as compared to that of other countries in the world economy. To illustrate: the difficulty of balancing the United States' current account balance is partly due to the fact that the South-East Asian countries (other than Japan) have let their currencies depreciate with the dollar. It is therefore no longer sufficient for the dollar to fall against the yen and European currencies. Other players have joined the game.

Another area calling for further research and study is **the change in our societies** with the rise in standards of education, the need to find new forms of work, new ways of organizing community life and a different role for central government and local authorities. All the structures of our societies are in a process of mutation.

Finally, OECD will have to give more thought to **managing natural resources**. We started a long while ago with the environment, mainly in our own countries, only gradually to discover that problems of ecological balance are becoming extremely urgent on a planetary scale.

- Better understanding and clearer explanation of economic and social realities are only the first two aspects of OECD's role. The third is equally important: **ensuring that governments make the most of this knowledge** in formulating their policies.

*How can OECD's specific assets be put to the best possible use at a time when international cooperation is tending to be concentrated within more restricted groups?*

Do you mean that OECD is becoming less influential because there is a Group of 10, a Group of 5, a Group of 7, the European Community, the Nordic Council, the Cairns Group and so on? My answer is no, not at all. On the contrary, this is an opportunity for us. The important thing is that international cooperation should develop on the basis of the most objective and in-depth knowledge possible of economic and social realities.

For there to be co-ordination of economic policies, we must have not only statistics and indicators, but also an understanding of the complexity and diversity of nations' economic policies. And who understands this better than an Organisation which, for more than 25 years (more, because it began in the days of the OEEC) has been regularly analysing every facet of these policies for all its Member countries? I think that we at OECD are well placed, perhaps more so than anyone else, to provide the necessary raw material – and the best suited venue – for any effort to co-ordinate economic policies. ■

# Job Creation in a Changing Economy



*Ruairi Quinn, Irish Minister for Labour and the Public Service, Chairman of the meeting.*

**T**he OECD Manpower and Social Affairs Committee met at Ministerial Level on 18th and 19th November, 1986, under the Chairmanship of Mr. Ruairi Quinn, T.D., Minister for Labour and the Public Service (Ireland). The Vice-Presidents were: the Honorable Benoit Bouchard, Minister of Employment and Immigration (Canada), Mr. Philippe Séguin, Minister of Social Affairs and Employment (France), Mr. Jan de Koning, Minister of Social Affairs and Employment (Netherlands), and Mr. Masuo Matsuoka, Parliamentary Vice-Minister of Labour (Japan).

Reviewing the employment and unemployment situation, Ministers noted that the recovery is continuing, broadly based across OECD economies. Employment is now growing in nearly all countries – briskly in North America, while generally more slowly elsewhere, and with significant differences among European countries. However, unemployment rates seem likely to fall next year only in North America

and a few European countries, whereas in most European countries they will remain very high, one reason being that more people will continue to enter the labour market. Long-term unemployment and youth unemployment pose serious problems in many OECD countries, as do demographic pressures between developed and developing countries. Thus, for the OECD area as a whole, employment and unemployment remain the weak links in the recovery.

Faced with these difficulties, Ministers reaffirmed their political will to take full advantage of the opportunity offered by improved economic conditions in the OECD area so as to achieve higher rates of growth and employment. Inflation is at its lowest for twenty-two years. Painful but necessary changes towards freer and more efficient markets are being progressively introduced. Priority must be given to accelerating this momentum to make significant progress towards higher employment and lower unemployment in OECD countries

over the next few years. To this end, labour market policies for the rest of the 1980s and beyond should have three central objectives:

- Higher rates of job creation, rather than counter-productive measures to preserve existing jobs, as the soundest path to lower unemployment
- More flexibility in expanding labour markets, so that the new job and training opportunities will result in higher employment
- More equitable and effective adjustment policies to help unemployed people at a particular disadvantage in finding jobs, thereby combatting their exclusion from active life.

The pursuit of these objectives should give full weight to the crucial role of women in the economy.

These goals cannot be reached without concerted efforts by all groups in society. There is a need for increasing social dialogue on such matters with and between employers and trade unions. The co-oper-

ation being developed between the Business and Industry Advisory Committee to the OECD (BIAC) and the Trade Union Advisory Committee to the OECD (TUAC) is welcome and useful; Ministers took due account of their respective views in the following conclusions about what now needs to be done.

### Higher Rates of Job Creation

The foundation of higher rates of job creation is stronger economic growth, for which economic co-operation between OECD countries and between the industrialised and developing countries is increasingly necessary. Labour market policies, collective bargaining and other forms of meaningful worker participation can contribute to such growth.

- Real wages can and should grow in most countries, but for the nation as a whole within what is earned by productivity gains, and reflecting changes in the terms of trade between countries. The key is to maintain moderation in growth of nominal wages, so that, without rekindling inflation, real incomes can continue to rise and contribute to the recovery.

- A more rapid growth of jobs will require more investment to rebuild the capital stock, including the economic infrastructure. Ways must be found to encourage the general public, including labour, to participate in this investment drive, through profit sharing, investment and pension funds and other creative ways of channelling savings into job-creating investment.

- Reducing rigidities and inefficiencies on the supply side of markets, capital as well as labour, will increase the freedom of governments to act by reducing the risk of re-igniting inflation or of losing competitiveness.

- Economic growth and jobs are also dependent on more open international trade. Attempts to protect jobs by restricting trade can at best only temporarily help workers in declining industries, and run the fundamental risk of triggering beggar-thy-neighbour policies which restrict the growth of employment for all. Continuing efforts will be needed in OECD countries to move to new activities and to relocate resources, not least to permit the continued growth of trade with developing countries, whose economic progress contributes increasingly to growth in the OECD area.

Even if stronger economic growth is achieved, the rates within realistic grasp, particularly in Europe, would be unlikely by themselves to bring unemployment down quickly to levels which are tolerable in human terms or politically acceptable.

New fundamental approaches must be sought to increase the job content of growth, because changing economic structures have altered the traditional mechanisms leading from growth to employment:

- The new information technologies, which affect office, factory, home and school, are a potential basis for a new wave of growth, jobs, income and shorter working time. Some countries see the reduction of working time as a means of increasing employment and distributing more evenly the benefits of the resulting productivity increases. Like previous breakthroughs, such as steam and electricity, the new technologies result in economic and social progress only when managers, working people and the population at large take part in innovation and change. In this spirit, Ministers have agreed to a Declaration on the Social Aspects of Technological Change (see page 11), the purpose of which is to help to create the environment for a widespread movement of innovation and change, inspired by the new technologies, and as significant as the productivity movement after World War II.

- The future growth of jobs will come mostly in services, mainly but not only in private enterprises. Governments should review the impact of policies – tax, sectoral, regional, and social for example – on the capacity of enterprises, both private and public, to create jobs. Key issues in some countries are how to reform taxes on labour and broaden the tax base, so as to remove bias against the use of labour. A number of countries see room for future initiatives to create jobs in socially useful fields such as social services, environment protection, and urban renewal.

- The new technologies lend themselves to initiative and enterprise on the small scale, and are relatively cheap in terms of their potential contribution to meeting the needs of society. There is a consequent need for the popularisation of entrepreneurship and for capital to be more accessible to the "new entrepreneurs". Policies, including tax policy, should encourage risk-taking. Legal and administrative disincentives to self-employment and to the creation and growth of businesses should be removed. In many countries training and advisory services for new businesses should be strengthened; access to credit and capital markets needs widening; and the growth of new forms of business, for example co-operatives, local employment initiatives and community businesses, should be encouraged.

- Local communities can play a growing role in job creation. Many have unused resources, including environmental and cultural assets, which need initiators and

sponsors to be mobilized. Public officials, the private sector and community associations need to co-operate to the good of jobs in their communities. Business has much to offer by making management skills, capital and markets available. National authorities should help to develop support structures and training for new entrepreneurs in local communities; foster appropriate decentralisation of decision-making and fund-raising powers; and where appropriate redirect some expenditures so as to stimulate the creation of viable jobs at the local level.

### More Labour Market Flexibility

As reflected in the above-mentioned Declaration, economic life today involves faster and continuing change, in part driven by the new technologies. Society must flexibly respond to the resulting new trends towards different kinds of jobs, new skills, new relationships between management and workers, and the more flexible organisation of enterprises – whilst at the same time sustaining social standards and employment security. Potential conflicts between these new opportunities and established patterns and interests need to be resolved. Otherwise a polarization of the labour force, and possibly of society, may result. Collective bargaining and other forms of labour-management co-operation, which have become fundamental rights for men and women in industrialised societies, provide the main mechanisms for labour and management to adapt to the economic and social forces that confront them. Public policies could help.

- New and flexible patterns of working time, such as leave for education and training, and labour market participation, such as part-time, fixed duration and temporary work are developing rapidly, and public policy needs to adapt to this. The aim is to facilitate enterprise efficiency, improve working conditions, respond to the aspirations of those who wish voluntarily to adopt new patterns of work or have to reconcile career and family responsibilities, and, in some countries, to improve the conditions for reducing working time. Social security arrangements should provide comparable cover for those in part-time and less secure work, and education and training be strengthened to provide a bridge to jobs with a future. Such issues could become a central plank in tri-partite consensus agreements in some countries.

- Other institutional and behavioural barriers to flexibility within enterprises should be removed, often in the context of the introduction of new technologies, to free



*The four Vice-Presidents:  
Masuo Matsuoka, Japan; Jan de Koning, the Netherlands;  
Benoit Bouchard, Canada; Philippe Séguin, France.*

the way for re-designing jobs, effect changes in work organisation, and facilitate the redeployment of existing workers, who should thereby enjoy more employment security and a higher quality of working life.

- Priority should be given to a high-quality basic education, and to further education and training both for young people and for adults who need to retrain for new skills and occupations or overcome functional illiteracy. By the end of the decade, facilities should be available for most young people up to the age of 18 or more to participate in education and training opportunities that will provide a bridge to working life, and enable them to adjust their skills over their life-time. More co-operation between labour market and educational authorities, and with employers and trade unions, is needed to achieve this.

- Social security arrangements, and in particular pensions and housing policies, should be reviewed to facilitate mobility between regions and enterprises, and to

support the more flexible life-time working patterns which will predominate over the coming decade.

### **A More Equitable and Efficient Adjustment Process**

Economic life today involves a faster and continual process of change. Much of this, including technical change, increases total productivity and income. But it may also impose considerable costs on the affected individuals, institutions and communities. Where this happens, society needs to ensure that the burdens and gains are equitably shared, with particular help for the most needy. If adjustment is to be a positive process, resources are needed to promote it, and co-operation is needed at all levels – within enterprises, between employers, trade unions, and governments and between all three and local communities. It is essential to seek viable alternatives to protectionism, and the following policy directions should be pursued:

- Major changes are needed in provision for the unemployed or the potentially unemployed. The tragedy is that the longer people are unemployed, the harder it is to get back into active life. Priority should be given to preventive measures, notably education and training, and active labour market measures to deal with the problems of those most hard-hit, notably young people, the disabled and the long-term unemployed, as well as migrant workers. For these groups, income maintenance is indispensable but not enough. Active social and labour market policies, often involving local communities and the private sector, are needed to get them back into the labour market. Unemployment compensation policies and other appropriate assistance policies should be developed to facilitate this reinsertion. It is also necessary to ensure that levels of unemployment compensation, trainee wages and minimum wages are so related as to encourage entry or re-entry into training or employment.
- There is a growing need for adult training and retraining, both as an investment in the efficiency of enterprises and to facilitate social adjustment. Firms should be encouraged to invest more in training; education and training institutions should be more responsive to the impact of new technologies on skills; and more education and training institutions for young people should be opened to adults.
- International co-operation is needed to phase out protectionist measures and to develop adjustment programmes for workers in economic sectors that have to adjust to freer international trade.

Each country should, the Ministers concluded, build active and realistic long-term employment policies in relation to the above three objectives of faster and more job-intensive growth, more flexibility, and stronger efforts to readjust the labour force, with appropriate forms of social dialogue. Such policies are the responsibility of governments as a whole, so that many government policies should contribute in their several ways to a concerted attack on the problem of unemployment.

The Ministers invited the OECD to promote international co-operation to follow up the above conclusions, and in particular to prepare a new framework for labour market policies, possibly in the form of an OECD recommendation, for the period ahead.

Given the great potential importance of the new technologies for growth, jobs and welfare, the Secretary-General was invited to establish a group of distinguished experts to report on their national and international implications both for employment and for our societies more generally.

# Declaration on the Social Aspects of Technological Change

## PREAMBLE

THE GOVERNMENTS OF OECD MEMBER COUNTRIES\* consider that rapid development and diffusion of new technologies is vital to economic and social progress. Believing that success in this respect will depend on there being effective means for dealing with the social implications they wish to make known their united views on the matter. They have accordingly agreed on a Declaration on the Social Aspects of Technological Change, as follows. This Declaration is intended to encourage and promote the good practices it describes, within the framework of the respective laws, customs and traditions of the Member countries.

### 1. CONSIDERING

that technological change is necessary to economic and social progress and should be welcomed and stimulated as a means for achieving non-inflationary growth, economic competitiveness and more and better employment as well as enhanced well-being for workers and consumers, rather than resisted because of fears of adverse social consequences, but that its successful introduction depends on adjustment measures to deal with such consequences;

#### DECLARE

that they will adopt policies to facilitate the continuing widespread diffusion and exploitation of new technologies within the framework of policies to promote non-inflationary growth, thereby decreasing unemployment, and to that end seek to ensure that any adverse consequences are mitigated by positive adjustment measures;

### 2. CONSIDERING

that the current rapidly expanding application of new technologies and its potentially differential effects on particular groups can lead to understandable apprehension and concern by workers about the security and quality of their jobs, this being particularly the case in a period of continuing high unemployment which makes the accompanying employment adjustments more difficult;

#### DECLARE

that the policies and practices by which adjustment has customarily been achieved may in some respects be inadequate and may require that different and more innovative approaches to the problems of social adjustment be introduced;

### 3. CONSIDERING

that the economic, educational, social and workplace dimensions of new technologies are interdependent and thus that the continuing efficient and socially acceptable introduction of

technological change requires a comprehensive and balanced approach by all concerned;

#### DECLARE

that the prime responsibility for dealing with the social aspects of implementing new technologies is that of employers, employees and their respective organisations, that governments should assist in creating an economic and social environment conducive to innovation and the introduction of new technologies; that they recognise that the continuing efficient and socially acceptable introduction of technological change calls for the timely provision by enterprises of information and consultation with employees and employee representatives according to the modalities of the laws, customs and traditions of each Member country concerning the impact of such change; and that they will encourage as appropriate a dialogue and consultations, i.e. meaningful discussions with all parties concerned, on suitable ways of dealing with the social aspects of new technologies.

### 4. CONSIDERING

that the rapid diffusion of new and sophisticated technologies will lead to changes in the structure of employment by industry, occupation, skill and geographic area, and will lead to the loss of some traditional jobs and the creation of new ones; that for these reasons there is a continuing need for the efficient functioning of the labour market to facilitate the mobility of workers within and between industries, occupations and areas;

#### DECLARE

that the flexible and socially equitable functioning of labour markets and the effective introduction of technological change within enterprises should be encouraged by reducing undue constraints on adjustment and by deepening the support for training and retraining, placement and employment counselling, geographic mobility both of jobs and workers, the better identification of future employment prospects and the exploitation of the employment generating potential of technological change particularly by employers, employees and trade unions;

### 5. CONSIDERING

that the rapid diffusion of new and increasingly sophisticated technologies requires an even more qualified work force with a broader range of skills, and thereby requires enriched basic education and continuing education, training and retraining of workers - whether employed, unemployed, new entrants or re-entrants to the labour market;

#### DECLARE

that substantial investment and technical support for modernised and responsive

research, education and manpower training systems, the provision of training and retraining by employers of employees at all levels is required if the current and future labour force is to respond effectively to the challenge of technological change;

### 6. CONSIDERING

that the introduction of new technologies and its accompanying opportunities for greater flexibility of work processes brings changes within enterprises, affecting the activities and policies of management and trade unions, widening choice in the content and organisation of work tasks, employees' responsibilities, the organisation of working time, pay structures, the working environment including safety and health; also that change comes about most easily and successfully where it is introduced equitably and with early provision of information and consultation;

#### DECLARE

that it is desirable that according to the modalities of the laws, customs and traditions of each Member country, employees and their representatives be informed and consulted, at an early stage, regarding the impact of the introduction of new technologies and that employers and employees and their representatives should cooperate to fully realise the economic and social benefits of new technologies as well as to prevent or mitigate adverse effects to the maximum extent possible; also that in introducing new technologies the enrichment of work tasks, increase in employees' autonomy, greater flexibility in the organisation of working time, and the improvement of working conditions, including safeguarding the privacy of workers, should be encouraged and that care should be taken to ensure that new technologies should not endanger but whenever possible should improve safety and health;

### 7. CONSIDERING

that if new technologies are to be widely accepted rather than resisted, it is desirable that there be opportunities for advancement, new employment, and adequate assistance for employees displaced or otherwise adversely affected;

#### DECLARE

that they will provide, where appropriate, assistance through education and training, job search and income support for workers displaced by new technologies; that they will encourage employers and employee representatives to provide assistance to displaced workers, and to seek to maximise the opportunities for employees opened up by new technologies within enterprises. ■

\* Including the European Community.

# 31 Million Reasons to Fight Unemployment

*"Thirty-one million jobless in OECD countries means thirty-one million reasons to make a dent in the unemployment figures." With these words, Ruairi Quinn, Irish Minister of Labour and The Public Service, set the tone for OECD's Meeting of Manpower Ministers over which he presided. OECD's Secretary-General, Jean-Claude Paye, echoed the sentiment, emphasizing that after 15 quarters of continuous economic growth – the longest upswing since the 1960s – there has been no overall reduction of the unemployment rate in the OECD area. The following article describes the background against which OECD's Ministerial meeting took place.*



**D**espite the creation of many jobs in the OECD area, the growth has not exceeded that of the labour force over this period of three years plus. The result: 31 million people – some 8 per cent of the workforce – will still be without jobs in 1987, with substantial variations between countries (see page 37).

## The Young and the Long-Term Unemployed

How has hard-core unemployment been faring in this OECD-wide context? The *unemployment rate of young people* is still higher than that of the workforce at large, even though it has fallen slightly in recent

years: from 17.7 per cent in 1983 to 16 per cent in 1987 according to the latest forecasts. The largest declines have taken place in Australia, Canada and Norway. The rate has also fallen in the United States, Finland, the United Kingdom, Sweden and Germany, where, it was noted during the meeting, the young remain unemployed for shorter periods (4.6 months less on average) than adults who overall are more qualified. Elsewhere the unemployment of young people has risen (Table 1).

As to the *long-term unemployed*, the most sustained reduction has taken place in the United States where those unemployed for 12 months or more was almost four points lower, as a percentage of total

## 1. YOUTH UNEMPLOYMENT IN 12 OECD COUNTRIES<sup>a</sup> % of total youth labour force

	1980	1984	1985	1986 <sup>b</sup>	1987 <sup>b</sup>
Australia	12.3	16.1	14.3	12 ¾	12 ½
Canada	13.2	17.9	16.5	14 ¾	14 ¼
Finland	9.0	10.4	9.1	9 ½	9 ½
France	15.0	24.4	25.6	25 ¾	26 ½
Germany	3.9	9.9	9.5	8 ¼	7
Italy	25.2	33.4	33.7	35 ½	37
Japan	3.4	4.9	4.8	5 ½	6
Norway	5.4	7.6	6.8	5	5 ¾
Spain	28.5	44.5	43.6	43 ¼	42 ¼
Sweden	5.1	6.0	5.8	6	6 ¼
United Kingdom	14.1	21.8	21.7	21 ¾	20 ¾
United States	13.3	13.3	13.0	12 ½	12
Four major European countries	13.6	21.6	21.7	21 ½	21 ¼
Total of the 12 countries	12.9	16.8	16.6	16 ¼	16
<i>Youth unemployment levels (millions)</i>					
Seven major countries	6.8	8.5	8.4	8 ¼	8
Four major European countries	2.7	4.3	4.4	4 ¼	4 ¼
Twelve countries	8.0	10.4	10.2	10	9 ¾

a) These countries represent more than four fifths of the youth labour force.

b) Estimates.

Note: The term "youth" generally refers to the 15-24 age group; for exact definitions and methods of calculation, see Employment Outlook, 1986, OECD (Table 10).

unemployment, in 1985 than in 1983, the peak year. In Canada and Australia the decrease in long-term unemployment has been roughly in step with that of overall unemployment. In Europe, the situation has not improved. In the 12 countries for which data are available it is estimated that in 1985 nearly 46 per cent of the unemployed had been out of work for over a year – some 6.7 million people in all. Though there has been a slight improvement in some low-unemployment countries, the general pattern is still one of rising long-term unemployment (see chart, p. 14).

### Economic Conditions and Job Creation

An examination of each column of Table 2 shows interesting differences, particularly between the United States and Europe. The two have broadly similar histories of GNP growth rates but strikingly different profiles of employment growth, labour productivity, investment and real wages.

Even though many countries expect a slowdown in the growth of the labour force over the next decade, this may not in itself be enough to bring about a significant reduction in unemployment. It will therefore be necessary to create many new jobs. The size of the task will vary from region to region and country to country. Everywhere

strong economic growth will be a necessary but not a sufficient condition, the ministers agreed: economic growth does not automatically create jobs. Growth must also be such as to favour a higher rate of job creation and to mesh with employment policies and social policies which can ease the difficulties of the unemployed and bring excluded groups into the labour market.

But it will be difficult in the next five to ten years, especially in Europe, to create large numbers of high-wage jobs. Job creation requires new investment. Thus for example the amount of extra capital needed to provide average-wage jobs for, say, 5 per cent of the work force would be on the order of 10-15 per cent of GDP, a high proportion of the approximately 20 per cent now devoted to capital formation in European economies.

Countries with high unemployment and a small margin of unused capacity could take two broad approaches. One is to continue the way of the last decade and to spread the capital over less than 100 per cent of the labour force – 90 per cent in Europe on average. This produces a reasonably rapid growth in labour productivity of those working but does not reduce unemployment. The alternative would be to spread the investment more thinly but

## 2. ECONOMIC PERFORMANCE AND EMPLOYMENT<sup>a</sup> Average annual percentage growth rates

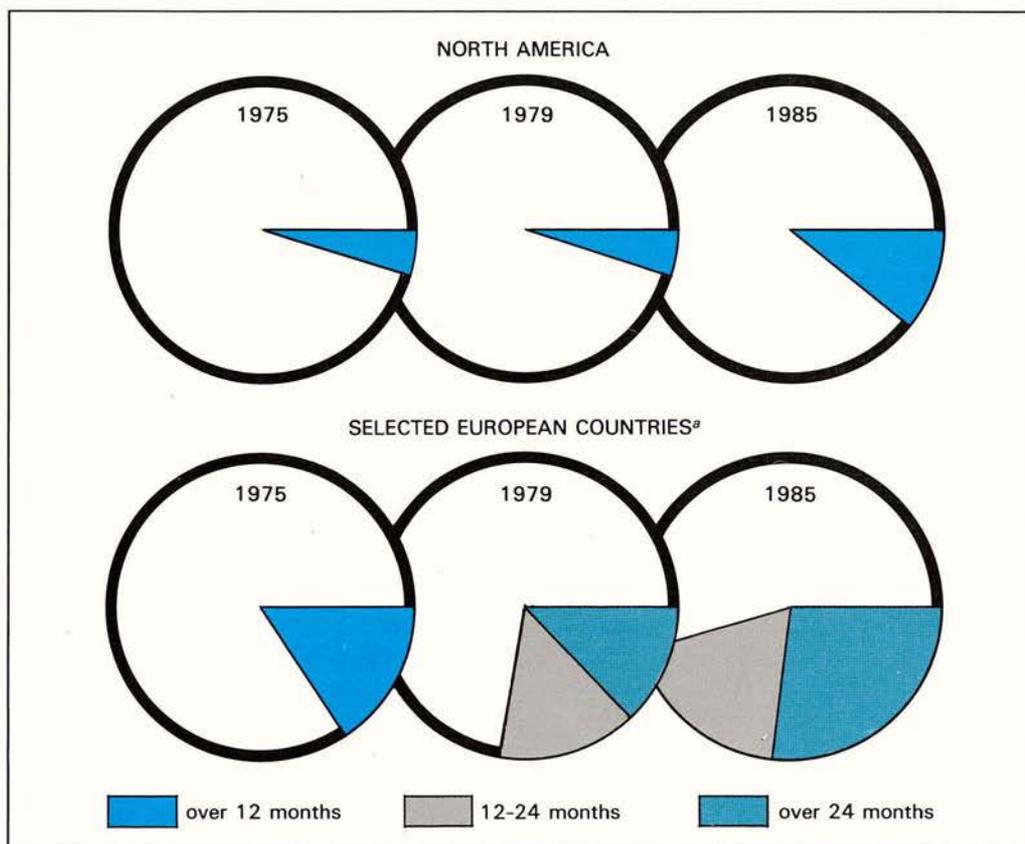
	GNP	Employment	Labour productivity per man	Investment	Real wages per person employed
United States					
1969-73	3.6	2.0	1.6	4.3	1.4
1973-79	2.7	2.5	0.2	1.6	0.3
1979-85 <sup>a</sup>	1.9	1.4	0.5	3.2	0.1
1969-85 <sup>a</sup>	2.6	1.9	0.7	2.9	0.5
Japan					
1969-73	8.1	1.1	7.0	11.2	11.1
1973-79	3.7	0.7	3.0	3.2	4.9
1979-85 <sup>a</sup>	4.1	1.0	3.1	1.7	3.6
1969-85 <sup>a</sup>	4.9	0.9	4.0	4.6	5.9
Europe					
1969-73	4.7	0.6	4.1	4.8	5.6
1973-79	2.4	0.3	2.1	0.4	2.7
1979-85 <sup>a</sup>	1.3	-0.2	1.5	1.5	1.0 <sup>b</sup>
1969-85 <sup>a</sup>	2.5	0.2	2.3	1.4	2.7 <sup>b</sup>
OECD					
1969-73	4.7	1.2	3.5	5.7	4.3
1973-79	2.7	1.1	1.6	1.1	2.1
1979-85 <sup>a</sup>	2.6	0.9	1.7	2.3	n.a.
1969-85 <sup>a</sup>	3.2	0.9	2.3	2.4	n.a.

a) Data for 1985 are provisional.

b) Based on figures for France, Germany, Italy and the United Kingdom.

Source: OECD Labour Force Statistics, National Accounts, Economic Outlook, No. 39. Reproduced from "New Sources of Job Growth: A Macro/Micro Perspective", OECD, 1986, Table 4.

## Proportion of Long-Term Unemployment in Total Unemployment



a) Belgium, France, Germany, Spain and the United Kingdom are the only countries which have data available for the years included.

Note: No breakdown between 12 and 24 months is available for Canada, the United States or the five European countries for 1975.

Source : Employment Outlook, OECD, 1986.

more widely across the entire labour force, including the unemployed. The result would be a lower productivity growth and slower growth of real wages but higher employment growth. The performance of the United States broadly illustrates the latter approach: growth in productivity and real salaries have been modest in the 1970s and 1980s, but employment growth has been strong.

To accept this arithmetic is *not* necessarily to accept the oft-cited argument that real wages must be reduced in order to increase employment. Rather it means recognizing that in the near future the resources will not be available in sufficient quantities to employ the majority of the unemployed in high-productivity, high-wage jobs.

The choice between the two approaches is to some extent a political matter, but it raises a number of key economic issues as well. While the "thickly-spread" route of many European countries results in relatively rapid growth of real (pre-tax) incomes for those who already have jobs, it has also resulted in a large number of unemployed, whose income maintenance has had to be financed out of taxes levied on the incomes of the employed. The other

route — lower pre-tax real wage growth but higher employment and thereby lower unemployment — requires less income transfer since there are fewer unemployed: tax rates, including those on income, can be lower.

It is increasingly clear, as stressed by Anna-Greta Leijon, the Swedish Minister, that maintaining the incomes of the unemployed is not enough. "They want jobs", she said. Implicitly, therefore, they prefer the "thinly-spread" option, which seems to them more equitable, to the "thickly-spread", capital-intensive one.

### Structural Change

A certain type of economic growth is a prerequisite for growth in employment. But well implemented policies can increase the flexibility of the labour market and thereby the capacity of economies to adjust to structural change (see box). Such policies can, therefore, lead to increased production and more jobs, by reducing some of the restraints imposed by the fiscal and monetary authorities, "without changing the workers' rights or job security" as the Spanish Minister, Manuel Chaves Gon-

zalez, noted. Governments must therefore play a major role in creating a social and institutional environment conducive to the diffusion of technological change (see page 11), the creation and expansion of dynamic firms (by facilitating their access to capital markets for example), and the investment of physical and human resources.

This is especially true for the small and medium-sized firms. "Not a single job has been created in the United States since 1979 by the 500 firms on *Fortune's* list of the largest corporations", U.S. Labor Secretary William Brock pointed out; "All the jobs that have been created have been in small and medium-sized enterprises, half

### Flexibility: The Demonstration Effect

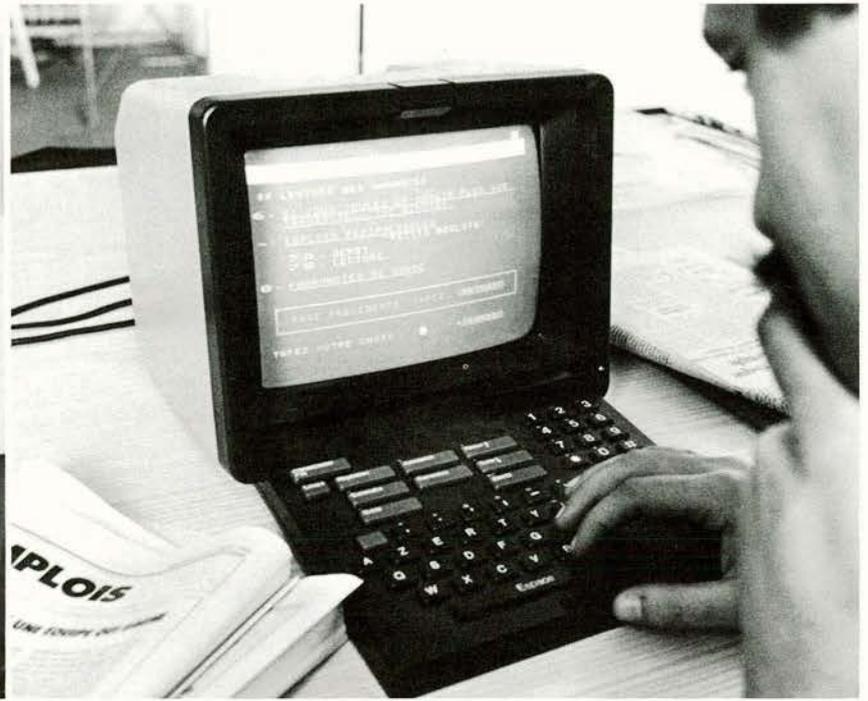
"The word flexibility has emotional overtones so, rather than talking about it in the abstract, we must show what it is in concrete terms. Take the case of working time. We have noted that attenuating the constraints imposed by laws or other rules does not suffice to promote flexibility. We have found that the constraints are deeply engrained in the attitudes of those engaged in social dialogue. Even when the doors are opened, birds that have been caged for a long time don't necessarily fly away. Similarly, if there is to be more flexibility, two things are indispensable:

- To show by actual case studies that more flexibility works better than less
- To break the link between flexibility and risk.

By giving part-time workers social benefits comparable to those of full-time employees, Belgium has succeeded in quadrupling the number of full-time workers who have freely chosen part-time work. Workers who take the plunge need a safety net.

The notion of flexibility must also be broadened. For example, if a worker interrupts his career, he should be able to return to his old job afterwards. Under certain conditions, a worker in Belgium can take six months or a year's leave of absence to take care of a child, to return to school etc. If he is replaced by an unemployed worker, he receives the unemployment insurance. Ten thousand workers have chosen this route in the course of a year, thus giving the unemployed a chance to become, once again, real members of the workforce."

Michel Hansenne  
Minister of Employment, Belgium



of them in firms less than four years old." Three explanations were given for this phenomenon: they are less strictly regulated; their rates of taxation are lower, and there is less social opprobrium attached to failure. Whether he succeeds or fails, the individual who launches his own business inspires respect in the United States, Brock added.

### The Growing Importance of Local Economies

All but neglected until now, local markets and resources could potentially create a considerable number of jobs. In Canada, 610,000 posts have been created in small communities in two years, Benoit Bouchard, Canadian Minister of Employment, noted. Local economies are a potentially fertile source of job creation for several reasons. First, structural change has had the most serious repercussions on employment in localities and regions where declining sectors such as steel, coal, textiles and shipbuilding were at the core of the economy. Second, the new technologies offer the prospect of dispersing production systems to other places than the main plant, and this could help to absorb available local manpower. In addition, the "new" needs that have become evident in advanced industrial societies — a growing female workforce, more elderly people, a deteriorating urban environment, for example — mean a growing requirement for services that are near at hand. The present trend for central authorities to delegate powers to other political and administrative levels should also contribute to local initiatives.

*Timothy, the parrot hero of a five-language cassette, allows young foreigners to discover France. The idea was thought up by a French woman worker made redundant by the economic difficulties of a publishing house (to left). "Transactel" a computerized system for advertising jobs, developed by two formerly unemployed workers (to right).*

### The Unemployed as Employer

*A number of unemployed workers have, with or without government help, become heads of small firms — a success story, according to certain ministers. In the United Kingdom after one year of government assistance, and three years of existence, 70 per cent of the firms established are still going, and many of them have recruited new workers. There has been roughly the same degree of success in Sweden, again after three years. The rate of success of these firms is of course greater than for the "normal" small firm but, as the Belgian minister stressed, so is the control over the experiment. In Australia, less than 1,000 workers have been involved, and it is too early to weigh the costs and benefits. The Australian minister foresaw the need for a safety net since the unemployed who experiment in this way will be worse off than the others if their firm fails: their personal savings will be gone and so will their unemployment benefits. Belgium has recognized the need for such a safety net by guaranteeing unemployment benefits to these workers for six years after a bankruptcy.*

### Realizing the Potential of Human Resources

Whether at local level or elsewhere, OECD governments have also been concerned with realizing the potential of human resources — the most important "commodity" in industrial and post-industrial economies. First, declining birth rates and an anticipated decline in labour force participation may mean that labour shortages will emerge in the long term. Second, in the shorter term, shortages of skills for some newly created jobs may appear even where there is still high unemployment. Third, technological innovation has altered the occupational composition of employment and the skill content of individual jobs. And this trend will continue. Finally, structural changes in industry and the professions require workers who can adapt. In this context, and aside from discussions about the relative virtues of general versus more technical or specialized education, the ministers expressed their concern about the functional illiteracy of young people even after they have finished their basic education.

It is clear that there must be much closer links between firms, the labour market, public education systems, and other educational structures. It would be desirable, British Minister Kenneth Clarke noted, citing his country's *Enterprise Alone* programme, for the financial support given to small industries to have a training element. The new links between various organisms trying to train today's labour force — and tomorrow's — would be more efficacious if they were to be established at local or regional level. ■

# Making the Cities More Liveable

*Policies for economic regeneration of cities, for more efficient public services, for better housing and for an improved urban environment must be examined from many points of view. Two main questions: Are they to be considered a community service to be funded by the public purse or a commercial activity to be provided by the private sector? Should the taxpayer or the consumer pay? In this context, OECD Ministers responsible for urban affairs came together recently to discuss how to revitalize urban areas.*



**T**he fact that OECD organized a Ministerial meeting on the theme of "revitalizing urban areas" was not indicative of a state of crisis afflicting Member countries' towns and cities, and Ministers made it clear from the outset that they did not feel they were presiding over the decay and degeneration of city life. Only a few years ago, the OECD's work in this field was indeed devoted to studying "urban decline". Now, by contrast, Ministers had come together to discuss the "development" and the "opportunities" of urban areas.

Even though the topic of "urban decline" may have been removed from the agenda, there are still plenty of "urban problems". The basic economic difficulties faced by towns and cities are twofold: in the first place, many have been transformed by structural change, their industrial base reduced if not wiped out by the contraction of traditional smokestack industries; secondly, the budgetary policies — usually those of central governments — have put severe constraints on the funds available to municipal authorities to finance the services they are required to provide. This squeeze

has affected not only the quality of locally administered public services (fire and police protection, refuse collection, transport, education and recreation, for instance) but also the level of welfare provision (care for the young and the elderly, health services) and, most fundamentally, the adequacy of modern housing. Funds for such uses as environmental protection and enhancement and amenities have been even more restricted in many cases.

## The City as an Economic Pole

While urban areas have been hard hit by these problems they also possess considerable potential for building a new economic base. Despite decentralization of manufacturing, they still probably have the necessary infrastructure, industrial and commercial premises, housing with the potential for renovation, transport and communications networks and, regrettably but all-importantly, a sizeable pool of surplus labour — the unemployed.

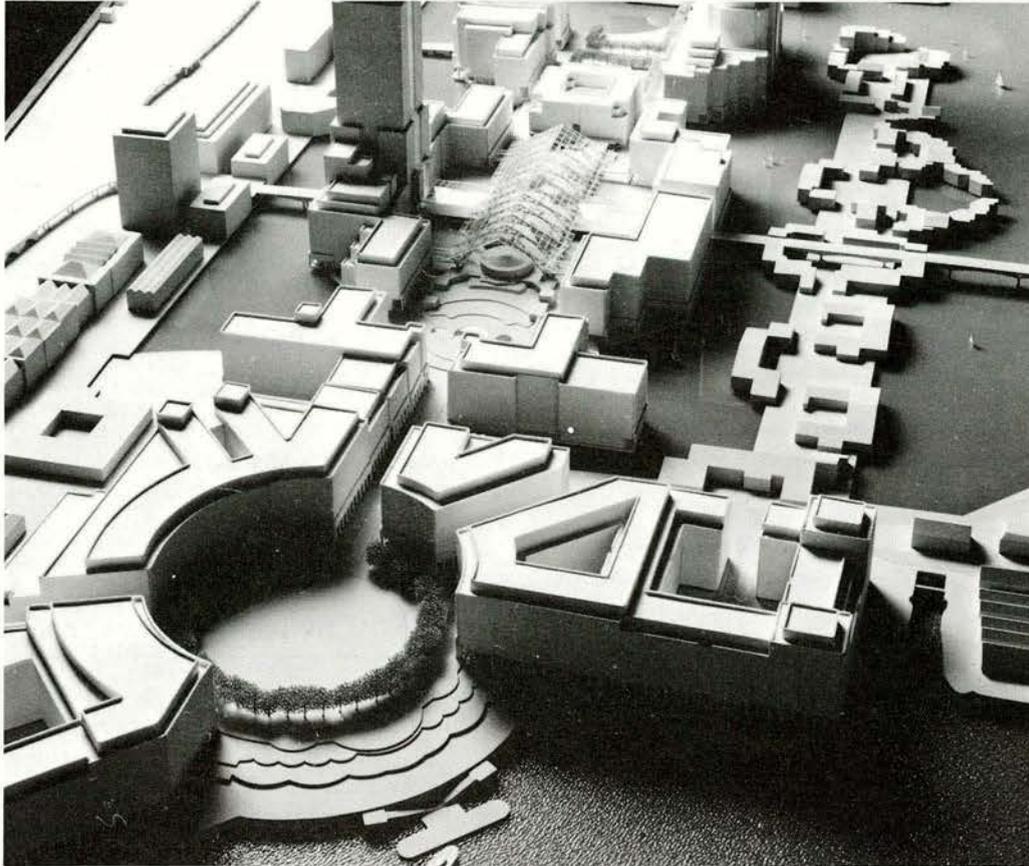
To take advantage of these resources, government policies are now being framed

to encourage new economic activities in urban areas, thus complementing other policies designed to cushion the impact of structural change. Although many urban economies have been run down in recent years, towns and cities still account for nearly 75 per cent of OECD countries' inhabitants. In the past, moreover, urban economies have been the powerhouses of national economic growth, and inner cities are now regarded as constituting suitable potential seedbeds for future innovation and entrepreneurial activity. The challenge for central governments is to create the right climate.

In this context, OECD's Urban Affairs Ministers showed keen interest in initiatives taken by the United States and the United Kingdom, both of which have in the past (their current policies are different) provided financial incentives for private sector investment in depressed urban areas. The British Minister for Housing, Urban Affairs and Construction, John Patten, outlined the United Kingdom's programme of urban economic regeneration — providing large amounts of public funds to replace infrastructure (through specially-

created Urban Development Corporations in six cities - London, Liverpool, Manchester, Birmingham, Newcastle and Teesside).

Grants to set up new businesses and other small projects in inner city areas have been successful in bringing in substantial private investment too, commonly at ratios of up to four to one, claimed John Patten:



*Architect's mock-up of one section of London's rehabilitated Docklands.*

"That means that for every pound the government puts up front, the private sector is matching this fourfold. That represents what we call good value for money, and this is what we look for in all our urban programmes."

The United States has succeeded in getting even better value from the private sector. Alfred C. Moran, of the U.S. Department of Housing and Urban Development, explained that its Urban Development Assistance Grants (UDAG) scheme had attracted \$6 from the private sector for every UDAG dollar expended. "The programme was targeted at the cities most in need and financed development that would not otherwise have taken place", he said.

Apart from maximizing national economic growth by bringing into play idle resources and above all the unemployed, another reason for promoting inner city regeneration is to prevent social alienation and dislocation. In this case, a purely economic approach may be inadequate.

## Who Should do the Financing?

Handing over responsibility for the provision of certain urban services to the private sector may result in better management and lower overall cost (as well as

savings to the central or local exchequer and, by extension, the taxpayer), but this alternative may be less than equitable if the consumer is required to pay and if the actual or potential users of those services are the people who can least afford them.

The provision of collective services has traditionally been assumed to be the responsibility of the community, and their cost was borne by the taxpayer. Recent developments have led people to question this conventional wisdom, however. Apart from the limit imposed by the worsening financial position of the public sector, demographic and social changes, such as the rising proportion of elderly in the population, the growth in the number of women in paid employment and increased leisure time have changed the pattern of demand for urban as for other services. At the same time, the decline in urban-based manufacturing, as well as technological advances in data processing and communications have not only changed the location of economic activity and the distribution of the population but increased the concentration of the disadvantaged, in

cities, putting greater strains on public resources.

These pressures have forced OECD countries to look at ways of improving the efficiency and cost effectiveness of urban services to ensure that the right services are provided for those who need them and that they give the best value for money, whether it be the user or the taxpayer who pays. To make service provision more responsive to the needs of the population, new responsibilities have been decentralized to local authorities in some cases or a role given to local level not-for-profit organizations and private enterprises. Lastly governments have, where possible, sought to pass on at least part of the cost of services to the user.

In some countries, such changes reflect no more than financial necessity. Elsewhere they also reflect the liberalist economic philosophy of the governments in office, this being notably the case in the United Kingdom, the United States, Germany and, more recently, France. Whereas the Scandinavian countries made it quite clear at the Ministerial meeting that they still cling to the notion of community services provided free of charge or heavily subsidized and that there is no place for commercial suppliers in the provision of collective services, the United Kingdom's John Patten put the case for those who believe the public sector cannot and should not do everything. In particular, he said, "local authorities have been instructed to tender for a whole new range of services, including cleaning, refuse collection, maintenance of buildings and vehicles".

Of course, providing services through private contractors instead of an in-house department is not synonymous with the user being made to pay. The two decisions are separate. Bringing in the private sector may simply mean that taxpayer funds end up on a contractor's instead of the government's payroll. In response to concerns expressed by Ministers from Finland, Sweden and Austria, Patten, who was concerned mainly about lower cost, described as a "false dichotomy" the argument that one had to choose between "a social or economic approach". There was nevertheless an overall consensus that, in the mixed economies of the OECD, finding the right balance between the contributions of each was the true problem.

## Housing

Nowhere were Ministers' concerns greater and the public-private division more acute than in the problems associated with providing adequate housing in urban areas. There was general agreement, though, that

the emphasis now should be on the maintenance and rehabilitation of the existing housing stock in urban areas rather than on major programmes of new construction such as those embarked upon in the 1950s, 1960s and 1970s. All countries seem to have the same objectives for housing their citizens, even though they may not be agreed on the means. Most OECD countries put the emphasis on promoting owner occupation, giving the private sector the responsibility for providing the accommodation but recognizing the need for governments to facilitate the provision of loan finance at reasonable rates of interest and to offer suitable fiscal incentives. On the other hand, most countries also stress the need to provide adequate private rented accommodation, but there are considerable differences as to the most effective way of ensuring such premises while preventing rents from rising to prohibitive levels.

An OECD report prepared for the Ministers concluded that housing conditions are generally improving in OECD countries but emphasized that there remain pockets of poor housing, especially in depressed inner city areas where ethnic minorities and the unemployed are concentrated. In countries where there is a rough balance between households and dwellings, emphasis is shifting towards maintenance of existing housing reinvestment. On the other hand, in countries where there is still an apparent shortage of housing (large cities in the Mediterranean region especially), new construction still accounts for the bulk of housing budgets though reinvestment will continue as well in most countries.

Tax concessions have traditionally been viewed as desirable, if not essential, to encourage people to buy their own homes so that governments can concentrate their housing funds on the less privileged. The cost to the exchequer of encouraging owner occupation has risen inexorably in recent years though, especially as assistance has been given to improve their dwellings and invest in energy conservations. Some OECD governments have tried to curb this growth by placing ceilings on mortgage interest relief or even abolishing allowances altogether. Further measures, however, are likely to meet with fierce political resistance.

Some countries regard the goal of guaranteeing all their citizens a roof over their heads a paramount social concern for government. Others called for a good mix of private and public sector housing, recognizing that "not everyone can and wants to own". There is, however, a problem of tenure in inner cities and the British government for example is trying to restore the range and diversity of rented housing. In



*Bicycles and pedestrians took over the Plaza del Popolo when cars were banned for a day. From now on, in certain historic parts of the city, the ban will be a permanent one.*

reply to his Scandinavian and Austrian counterparts who stressed government's social responsibility in housing provision, the British minister invited them to "come and see the massive housing estates in the UK", describing them as a "failure of policy geared to social goals". Responding to the characterization, Sweden's Housing Minister, Hans Gustafsson, stressed the need for "a balance of different tenure possibilities" while pointing out that 78 per cent of Swedes are owner occupiers. "I agree that we must make the optimum use of available resources... but we shouldn't look towards increased privatization, especially for infrastructure." And he cautioned in particular: "There shouldn't be parts of towns where we put people with problems."

In Finland, the people with housing problems represent a third of the population, according to Matti Ahde, Minister of the Environment. "The vast majority of these people are in towns. They cannot assure their housing situation on their own, so governments or municipalities must take the responsibility," he contended. Finland's main problem is a shortage of rental accommodation. "There are lots of flats empty and long queues of people wanting to rent," he said. This is a familiar problem in many countries, of course, where laws aimed at protecting tenants often succeed in drying up the supply of private rented accommodation.

That has occurred in France, for instance, but Pierre Méhaignerie, Minister for Urban Planning, Housing, Regional Development and Transport in the government that came to power in March 1986,

told the conference that he was planning "to progressively liberalize rents so as to eliminate the perverse effects of the old (rent control) law".

### Upgrading the Urban Environment

Ministers' views on the areas most in want of improvement in towns and cities differed considerably. Nevertheless there was absolutely no disagreement on the need to protect and upgrade the urban environment which, apart from any lack of trees, greenery or open spaces, is particularly exposed to air, water and noise pollution, to the decay of historic buildings and monuments and to all the discomforts associated with road traffic. OECD Ministers appeared both concerned and committed to improving the quality of life in towns and cities, not only for its own sake but also to enhance their competitiveness in attracting and keeping economic activity.

The Scandinavian countries are particularly concerned to reduce air, water and noise pollution in towns. "Sulphur emissions are to be cut by 50 per cent from 1980 levels by 1993, and we are making lead-free fuel the cheapest," Finland's Matti Ahde said. The Norwegian Minister of Local Government and Labour, Mr. Leif Haraldseth, also noted that "cutting down exhaust emissions and dealing with the problem of traffic is essential." While Denmark's Environment Minister, Christian Christensen, said that improving the environment meant "eliminating pollution and noise." He added that environmental protection also meant arresting the dereliction and decay of existing buildings and the restoration of historic areas.

# Safer Products for the Consumer

by Nils Ringstedt<sup>1</sup>

In Italy, too, traffic is a special problem though obviously not the only one. Mr. Mario Tassonem, Under-Secretary of State for Public Works, suggested that traffic was a major factor in the quality of life and that it needed planning as much as any other aspect of the environment. "We also want to install parks and gardens to improve the quality of life and restore and upgrade the historical centres of our towns and cities." France has treated the protection and restoration of the historic centres of its towns and cities as a major priority as well. Pierre Méhaignerie stressed that this policy had been applied to all major towns, not just Paris, and that care had been taken to ensure that new buildings developed in these centres were of a style and a splendour that matched the existing structures. The other main French concern has been to rehabilitate the rundown suburbs and outskirts of certain big towns.

In Turkey, environmental upgrading has concentrated on demolishing and converting disused industrial premises in urban areas. Safa Giray, the Turkish Minister of Public Works and Housing, said industrial plants were the main source of pollution in towns. "We have launched an urban renewal project in Istanbul involving the destruction of 2,500 industrial and commercial units and 8,000 housing units to make room for parks and gardens on either side of the Golden Horn." In the Netherlands, on the other hand, urban renewal has meant the redevelopment of old industrial sites.

In Spain, Juan Ignacio de Zumarraga Zunzunegui, Director General of the Institute of Land and Town Planning, explained that there had been something of a shift in urban development and environmental protection policy. "Our strategy is to revitalize city centres in order to keep them intact. It is a policy of slowing down decay. In the past, our policy was to develop outer urban areas, green belts, and so on." Spain is also tackling the problem of air pollution from road traffic as part of a general concern to improve the quality of life in cities.

\* \* \*

Once the Ministers started talking about upgrading the environment, little mention was made of financial strictures nor was the private sector or the user apparently being asked to pay for improvements in the quality of life. The positive challenge of reducing pollution and preserving the cultural heritage is one that OECD countries are evidently meeting with enthusiasm. The problems and shortcomings of the past and present are viewed as the opportunities of the future and that attitude characterizes the Ministers' overall approach to the multiplicity of concerns that fall under the general heading of urban affairs. ■



In a 1984 exhibit in a Paris subway station, a "giant's house" brought adults down to the size of a 2 or 3 year old to show them how dangerous everyday surroundings can be for a child.

The quantitative importance of accidents in and around the home is frequently underestimated. In the Netherlands, for example, with a population of 14 million, 57 people died in industrial accidents in 1983, 1,804 as a result of road accidents and 2,356 from accidents in the home. Dutch hospitals treated 2.3 million cases, 700,000 of them as emergencies, following such accidents, according to a survey in the early 1980s.

This is by no means an isolated experience. In all OECD countries which collect data on the subject, injuries and deaths resulting from accidents in the home and at play generally outnumber those occurring in accidents on the road or at work. Obviously, it is not only the consumer product as such that directly causes these accidents. Falls, for instance, are the most frequent cause of accidents in the home (75 per cent in the Netherlands and 62 per cent in the United Kingdom) and the "product" most frequently involved is — inevitably — the stairway. But too often, badly designed or badly used consumer products are implicated.

The notification system, operated by OECD's Consumer Policy Committee,

which generates information on products that have shown themselves to be dangerous, that have been recalled or been banned shows that the spectrum of consumer products involved in such accidents ranges from relatively exotic novelty items to very commonplace ones that nevertheless can cause serious injury or even kill.

The number, gravity and cost of these accidents to the health services, added to the pressures brought by the media and consumer groups, have led governments, manufacturers and distributors to develop a more systematic approach to product safety problems and to revise their institutional and legal approach. To help them in this task, OECD's Committee on Consumer Policy has just published a review of the systems Member countries have put in place to promote greater product safety.<sup>2</sup> ▶

1. Chairman of the Working Party on Safety of Consumer Products of OECD's Committee on Consumer Policy.

2. Product Safety — Development and Implementation, to be published shortly.

Between 1975 and 1977, an estimated 700 people were electrocuted while putting up CB antennas. Since then, mandatory performance standards have come into force. Above: a French CB operator.

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## The Power of the Law

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As the survey shows, the bulk of the industrialized countries have the instruments needed to develop product safety measures. In many countries, consumer protection measures in the food and drug industries and those linked to technical appliances antedate product safety measures of a more general nature. Thus some legal systems are based on laws relating to specific product categories. This is true in the Federal Republic of Germany, the Netherlands and Switzerland.

In other countries, consumer protection is dominated by strong laws on marketing practices (in the broadest sense), and product safety is considered an element of fair trading. This is the case in Australia and in the Nordic countries.

From the 1970s on, still other countries, including France, the United Kingdom and the United States, for example, have preferred general product safety laws which set out basic principles of product safety, allow regulation of specific product areas if necessary and include powers to handle post-marketing problems.

In the United States, to take one case, the Consumer Product Safety Act covers virtually all consumer products, except the ones covered by specific regulations – food, drugs and automobiles – and the Consumer Product Safety Commission has jurisdiction over more than 15,000 products. If the Commission considers a product to be hazardous, it may issue a specific ruling, impose a recall or even ban the item.

In the United Kingdom, the main legislation is the 1978 Consumer Safety Act, administered by the consumer safety unit in the Department of Trade and Industry. The unit can draw on four types of *mandatory* measures:

- Safety regulations, which set out long-term requirements, such as obligatory labelling, for certain types of product
- Prohibition orders, valid for a maximum of a year, for products considered to be unsafe
- Prohibition notices (similar in effect to the preceding except that they apply to a single supplier)
- "Notices to warn", if large supplies of dangerous goods have already been purchased.

In France, the Hazardous Products Act of 21st July, 1983, instituted a consumer safety commission composed of judges,



experts and consumer and business representatives. The commission's powers are mainly consultative, though it can *recommend* measures to prevent risks or accidents. Regulatory power lies with various government departments which can issue injunctions and order control and testing of goods and services.

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## Relying on Voluntary Measures

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Whether rules are general or product-specific, however, "voluntary" arrangements, meaning self-regulation by manufacturers, also have a role to play. Co-operation between public officials and manufacturers is becoming more and more common. An example is the Japanese toy industry: in order to qualify for the so-called ST (for safe toys) mark, toys must pass a test on a model product conducted by an inspection body approved under the Industrial Standardization Act. The standards for obtaining the ST mark, which is valid for two years, are developed by a special safety committee in the Japanese Toy Association. It includes representatives of government and consumer organisations, experts, manufacturers and distributors. Currently more than 90 per cent of the toys on the Japanese market carry the ST mark.

In many countries – Sweden is another example – close co-operation between industry and the relevant product safety authorities has become the rule, and compulsory measures are only envisaged when it becomes clear that voluntary measures will not work.

Close co-operation between industry and the authorities also means that occasionally the initiative for imposing mandatory rules can come from manufacturers. One example is the CB (Citizen's Band) antennas in the United States. Between 1975 and 1977, the peak years for sales, they caused a number of deaths and injuries. An estimated 700 people were electrocuted while putting up or taking down omnidirectional CB base-station antennas which came into contact with power lines. After investigation, the Consumer Product Safety Commission decided to issue a labelling rule requiring manufacturers to warn consumers of the electrocution risk. Three years later, the Commission was forced to conclude that there were still too many accidents. After talks with the industry and consideration of a voluntary standard, in 1982 the industry informed the Commission that its members believed that a mandatory standard would better ensure uniform compliance, and the Commission settled on mandatory performance requirements.

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## Market Forces

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Ranging from government control to self-regulation by manufacturers and distributors, consumer protection methods are varied and complementary. From the point of view of the consumer, the effective application of the methods chosen is crucial for the credibility of any product safety policy.

"Enforcement problems in most Member countries result from the fact that supervisory bodies (constrained as they are) are

continuously confronted with dynamic markets, with products that are often modified and with entirely new products", the authors note, further observing that agencies have insufficient staff or technical resources to carry out their duties. The quantity and variety of products, real or pretended innovations, minor or even major technical changes in highly complex products constitute a permanent challenge for the supervisory bodies, and a problem of cost-effectiveness which means that priorities must be set.

In the United Kingdom, enforcement of consumer safety legislation is entrusted to the trading standards departments of county councils. In France, responsibility for enforcement lies with competition and consumer protection officials, weights and measures inspectors, customs officers, veterinary services, health and labour inspectors, pharmacists and the police. Canada has inspectors who are assigned to regional offices and are responsible solely for consumer product safety.

Identifying a hazardous product is no small matter. The shortage of manpower and resources is perhaps the most important obstacle for enforcement agencies, but there are others as well. They include:

- A lack of practical experience with the control of products other than food because systematic state intervention in the product-safety field has started only recently
- Lack of coordination between independent inspection services and inadequate communication between these services and the ministries
- Lack of organization on the part of trade and industry, which makes it difficult either to consult manufacturers, importers and traders, when statutory regulations are being prepared, or to control compliance
- Lack of any international exchange of information and cooperation between control services and administrative authorities. This would be especially important in the case of dangerous products that are traded internationally
- The often relatively low penalties exacted for offences against product safety rules.

Evaluating the efficiency of supervisory bodies in this field is in any case difficult. The number of consumer products that could be considered dangerous is relatively small compared with the totality of consumer goods actually on the market. The supervisory bodies are therefore judged by the public and by the business community on their capacity to detect the few extreme cases in which consumer goods would be directly harmful to consumers. To do this, however, they have to control a large market of products, and inevitably, also determine what minor deviations from

existing safety rules could possibly be tolerated from a cost-effectiveness point of view.

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## Intergovernmental Cooperation

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At international level, product safety is by no means a simple problem. The development of product safety measures can directly impede the flow of goods and services if national standards diverge. Enforcement of such measures, through bans or recalls, can work in the same direction.

*National* product safety laws do in fact differ in their basic approach, coverage and the degree of detail defining a "safe" product. Nonetheless, product standards developed by national standardization bodies still form the technical backbone of safety work in most countries. Hence, various harmonization activities aimed at avoiding such barriers to trade have been institutionalized in Europe and internationally. Yet problems persist, because the number of national regulations and standards is multiplying rapidly. The development of *international* standards lags far behind.

The existence (and occasionally the deliberate creation) of divergent national safety requirements has served as the classical example of a non-tariff barrier for many years. It is particularly easy to apply and allows consumer bodies and other authorities to demonstrate their vigilance in the defense of the consumer's health and safety. It is a "public good" appreciated by the society and readily reported on by the media.

Although it is recognized that products which are not safe for the consumers in one country should also be considered unsafe for those in another, the practical impact of this realization is not yet evident in such areas as the implementation of product bans or recalls for example.

On the other hand, the detection of foreign products presenting an unsuspected hazard can provide an opportunity for countries to impose import restrictions which can by far exceed in scope the hazardous goods involved.

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## Suggestions For Action

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What can be done to improve product safety? There is no simple panacea in an area where different technical, economic and socio-cultural factors determine what is considered a "safe" product. The Committee's suggestions:

- Product safety policies and priorities are not totally dependent on quantitative data – they often also contain an emotional element – but numerical analysis is an

important basis, whether used to support proposed action, to define priorities or to obtain quantitative proof to refute claims made by industry. The development of specific data collection systems related to inquiries involving consumer products should therefore be further pursued<sup>3</sup>, but consideration should also be given to a more systematic use of other available data sources, including consumer complaints. The international comparability of such accident data could be improved by the development of an international coding scheme.

- In the interest of the transparency of the decision-making process, governments should set out the criteria used to initiate measures, the procedural steps that will be taken, the choice between policy options and the methods for monitoring the implementation of the measures and evaluating their efficiency in terms of the objectives pursued. It should include examination of possible voluntary measures in the form of self-regulation by industry or voluntary guidelines, such as those negotiated between professional organisations and the product safety authorities. Bearing in mind the benefits of voluntary measures – business involvement, flexibility and reduced state resources for development and enforcement – their potential limitations must be kept in mind, e.g. the danger that incomplete coverage might seriously limit their effectiveness and create competitive distortions.

- In the development of national product safety measures, the experience of other similarly oriented countries as well as international standards and test methods should be taken into account. Consideration of the impact on international trade should be an integral part of the decision-making process on safety matters. On the enforcement side, this would have to include an examination as to whether there are adequate mechanisms for coordination between customs and product-safety authorities.

- Product-safety authorities should undertake a critical analysis of the existing framework for the implementation of the measures already taken, including coordination of the flow of information between the various groups concerned with complying with safety rules. Where appropriate, the re-organisation of control functions should be considered, in particular concentrating on early stages of the distribution process i.e. at the level of manufacturers and importers. Finally, appropriate use should be made of decentralized structures such as local consumer groups and consumer advice centres in the implementation of safety measures. ■

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3. Such data collection systems currently exist in six countries – in Canada, Japan, the Netherlands, Sweden, the UK and the US.

# Life Insurance: Is it a Good Investment?

Life insurance is big business in OECD countries, which account for 95 per cent of the world's total investment in life insurance policies. In 1984, some \$205 billion of new funds were invested in life insurance premiums in the OECD area. The industry thus bulks large in the economic life of Member countries and is a major channel of investment in industry at both a national and an international level.

For most individuals, life insurance provides both a form of protection and a mode of saving. In particular, it eases the financial disruption for a family in the event of the breadwinner's death, but it can also provide financial provision for his retirement. As such, pension plans with life insurance companies supplement (or in some cases replace) state pension schemes, and to that extent the life insurance industry alleviates one of the principal financial burdens falling on governments today. In many countries, governments recognize that contribution, by granting tax relief on life insurance premiums and on the proceeds of their policies, and may also accord certain privileges to life insurance companies. The two main exceptions to that rule are Australia and the United Kingdom; tax relief on premiums was abolished in the U.K. in 1984, because it was believed to cause distortion in the savings and capital markets, while Australia followed suit in the context of a major tax reform in 1985.

There is expected to be an increase in voluntary retirement plans linked to life insurance in future, at least in countries and sectors where state or employer pension schemes are considered inadequate. In particular, doubts are being expressed about the effectiveness of non-funded pension schemes because of inflation, the rising proportion of non-earners (because they are already retired or unemployed) and the overall population decline.

The life insurance industry is subject to government control and scrutiny in all OECD countries, although the extent of that supervision varies considerably. In the United States, it is the responsibility of individual states. In the European Community, too, each member state has its own separate laws, although some basic provisions have been harmonized within the 1979 Life Insurance Establishment Directive. The regulatory measures applied in OECD countries include the control of

*Consumers often have a difficult time when shopping for a life insurance policy. A recent OECD report on the life insurance industry calls for greater transparency to give consumers all the information they need to make a reasonable investment decision<sup>1</sup>.*

access to the industry through licensing requirements and continuous supervision of the solvency of existing firms.

As regards entry control, the main differences relate to the treatment of foreign firms. Most countries permit foreign companies to operate, although in practice access may prove difficult (in Japan, for instance). Foreign life insurance companies have traditionally accounted for a significant share of business in Canada and Australia, while the United Kingdom has a particularly liberal attitude to foreign firms, which may sell policies in the country without having to establish themselves there. The EEC's 1979 Directive has opened up member countries' markets, but only to firms based in other EEC countries.

More importantly, perhaps, governments must ensure the solvency and long-term viability of life insurance firms, given the time scale of their commitments. Not only must companies comply with regulations requiring them to maintain a prescribed ratio of surplus assets to income from premiums; they are also bound to supply the general public with life insurance at a reasonable price. That objective may be achieved solely by reliance on market forces, or through imposing formulas for the calculation of premiums, surrender values, policy loans and interest on amounts due for payment. Such regulation of the industry does limit the scope for price competition between firms, however, and in many countries the industry is exempt from competition laws.

## A Variety of Policy Plans

The choice of life insurance policy available to consumers is very wide, so much so that they have always had difficulty in deciding which is most appropriate to their needs. Basically, the individual has to choose between a policy that provides protection only and others that offer a combination of protection and savings. *Term policies*, for instance, provide protection for a fixed period of time and are the least expensive cover available, but they have no investment value. A variety of policies include an investment component, the main types being whole life, universal life, unit-linked life and endowment insurance. A *whole-life policy* remains in force for the life of the insured, the policy amount being paid on death, but it has a savings element insofar as the policy can be terminated at any time and the cash value of the policy recouped. *Endowment policies* are a popular form of investment-oriented insurance enabling the policy-holder to receive the proceeds of his policy if he survives the term. *Universal policies* carry separate charges for the protection and savings components and offer a more transparent rate of return. *Unit-linked policies* comprise a savings component based on an investment portfolio managed either by the company itself or an external investment firm, and these are also more transparent than whole life or endowment policies.

Variations in the policies offered by different companies relate to features like surrender values and the bonuses payable on with-profits policies. The surrender value is the amount received by a policy-holder who terminates his policy before death or maturity. The amount is low in the early years of a policy because of the high initial expenses charged at the outset and the agent's commission. The policy-holder has the alternative of freezing his policy, of making it "fully paid-up", so that he pays no further premiums, his insurance cover is reduced commensurately and he receives payment when the policy expires.

With-profits policies (which are compulsory in some countries) give policy-holders additional bonuses based on the financial performance of the company. This increases the value of the investment component, although higher premiums

1. Consumers and Life Insurance, OECD, 1986.



*Insurance agents play a decisive role in determining whether life insurance is a good investment or not.*

have to be paid for the same life insurance cover. Policy bonuses can either be re-invested in the policy or be cashed in during the life of the policy. *Non-participating policies*, on the other hand, do not have any unknowns, but involve fixed premiums, a fixed sum assured and a guaranteed cash value.

For the consumer, it is important to make the right choice both in terms of the rate of return from the savings component and as regards the surrender value. The insured needs to compare the return with the rates of return he could obtain from alternative forms of investment, and he must have the assurance of a reasonable surrender value should his circumstances force him to cash in his policy prematurely.

One of the main problems for consumers is simply their lack of knowledge or understanding of life insurance. In some countries, governments have taken steps to provide consumers with basic information about the different types of life insurance, but the individual must also glean as much as possible from other sources, including intermediaries and the industry itself. It remains difficult, however, to compare rates of return between different investment vehicles, or even between the many companies offering the same sort of scheme, because of lack of agreed, objective criteria. Moreover, consumers have to rely on past performance in order to make a judgement about a policy that may run for many years into the future. One approach for evaluating schemes with an investment component is the so-called Linton yield, which measures the rate of return on

savings, but critics have pointed to a number of shortcomings in this method. Even so, it certainly provides some indication, and comparative studies that have been made in the United States, United Kingdom and elsewhere have shown wide variations in rates of return both between life insurance schemes and other investment vehicles and between the policies of different insurance companies. When it comes to surrender values, the consumer can similarly try to distinguish between the terms offered by different companies, but surrender values are generally low in the first years of a policy.

Insufficient information makes it hard for consumers in many countries not only to make comparisons between different forms of investment and different companies but also between the protection and savings components of life insurance policies. While more transparent universal life and unit-trust-linked policies have facilitated the choice of British and American consumers, the advertised rates of return of some of these policies have been criticized as inflated. Unless there is readily available and frequently updated information on rates of return on investment, consumers cannot evaluate endowment and whole life schemes vis-a-vis universal policies or the option of basic term insurance combined with a separate savings plan.

Steps have been taken in some countries in recent years to improve information disclosure so as to simplify comparisons of life insurance and savings options. A model disclosure regulation was published by the National Association of Insurance Commissioners (NAIC) in the United States more than 10 years ago, recommending the disclosure of data on costs and annual dividends, but the Federal Trade Commission found that consumers did not really understand these and proposed its own model disclosure system, which would have provided consumers with the Linton yield, a second cost index (the surrender or interest-adjusted cost index) and simple explanations. The provision of such simple measures may not be sufficient to cover all the complexities of life insurance, however.

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## Intermediaries

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The role of intermediaries is central to the functioning of the life insurance market and the choices open to consumers. Whether as exclusive agents for one company, as employees of life insurance firms or as self-employed brokers acting for a number of firms, intermediaries are the most important channel for the sale of life insurance.

While insurance agents should be in a position to provide consumers with advice on the relative merits of the different companies whose policies they offer, their interests and loyalties reside with the company or companies they represent. Brokers however, unlike agents, are con-



## Consumer Complaints

Complaints about insurance companies' response to claims need to be handled smoothly and promptly, since claims are often made in times of emotional as well as financial stress. Consumers need to know whom to turn to if they are not satisfied and be assured of an impartial decision. In a number of countries, this task falls to the Insurance Ombudsman who, even where he has been created by the insurance industry itself, operates totally independently. Other countries have established complaints procedures through bodies set up by, or in cooperation with, insurance companies, but although they may well deal with complaints fairly and efficiently, they tend to be perceived as less impartial than an independent ombudsman.

Complaints may relate not to the amount received from the surrender or maturity of a life insurance policy but simply to slow payment. Delays are a problem in many countries, although they may well not be the fault of the insurance company itself but of complex or lengthy legal and administrative processes. In some countries, insurance companies may be required to compensate beneficiaries for loss of interest in cases where there has been undue delay in payment.

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The evident difficulties encountered by consumers in shopping for life insurance should induce governments to assess whether consumers are adequately protected and informed.

Informed consumer choice requires not only general information about life insurance alternatives but more detailed and specific information facilitating a meaningful comparison of the relative merits of different policies and companies as well as of the value of savings-related insurance schemes relative to other forms of investment. It would be useful to develop and apply a set of measures that would allow consumers to make valid comparisons of protection, costs and guaranteed or projected rates of return before choosing which policy to buy.

As far as the particular consumer concern about low surrender values is concerned, it might be helpful to require companies to disclose in advance what cash values can be expected at appropriate points in the life of the policy. Greater transparency as to the penalties of premature surrender would enable consumers to make informed decisions at the outset concerning the relationship between early cash values and subsequent benefits and may help reduce the number of cancellations.

considered to work for the insured, not the insurer. However, the impartiality of the broker towards the consumer cannot always be guaranteed, since some have ownership or organizational ties with companies. They cannot, therefore, always be relied upon to provide accurate cost comparisons between different policies.

A particular problem with intermediaries is the "front-loading" of their commission, so that most of it is paid in the first years of the policy. This encourages the intermediary or intermediaries to make new sales rather than renew existing policies. Moreover, intermediaries are encouraged to sell savings-related policies, regardless of the consumer's wishes, because they attract significantly higher rates of commission than ordinary term policies.

Some countries have taken steps to license and register insurance intermediaries but, in others, there are no regulations governing their activities. One recent proposal is that the intermediary be required to declare his own self interest in the transaction before any contract is signed, so that the consumer can make his own judgement of the impartiality of the advice he has received. One notorious practice is known as "twisting", in which the intermediary advises the policy-holder, against his best interest, to cancel an existing policy and replace it by another, resulting in a loss to the consumer because of the low surrender value and a gain to the intermediary through his front-loaded commission. Some countries have taken steps to curb such abuses while preserving the legitimate promotion of new and better policies.

## Contract Terms

When it comes to the drafting of the contract, the insurance company is dependent on the information supplied by the

*The essential difference between life insurance policies is whether or not they also constitute a means of saving.*

customer, who is legally bound to provide full and accurate answers to the company's questions. Contracts consist of a set of standard clauses and conditions covering subjects such as incontestability by the policy-holder, grace periods for premium payments, non-forfeiture provisions, surrender values, dividend and bonus entitlements, consequences of death by suicide, reinstatement of cover and the assignment of the proceeds of the policy.

The extent to which standard terms and conditions can be negotiated varies considerably, with some countries allowing no modifications to the standard contract while others leave the market to determine contract terms. In between, some countries have established rules setting out the requirements for "fair" terms and conditions or require standard contracts to be approved by supervisory authorities.

Since the insurance company's terms and conditions, and certainly its product pricing, are based on the information supplied by the consumer, it is not surprising that in most countries insurers can exercise sanctions if the consumer has misrepresented a material fact. In some countries, though, the insurer must be able to prove that the insured answered untruthfully with intent to deceive. Some countries also fix a time limit beyond which an insurance company cannot take action against misrepresentation (except that it usually retains an indefinite right to adjust the contract if the policy-holder has misled it about his age).

Given the complexity of life insurance contract terms, some countries have also introduced the notion of a "cooling-off" period, which gives the consumer a fixed period within which he can cancel the contract.

# The Cost of Education: Doing Better With Less



*Since the middle of the 1970s, falling school rolls (as a result of declining birth rates), combined with a concern to limit public expenditure, has led most governments to curb outlays on education. Spending restrictions have not, however, affected all levels of education in the same way. An OECD report will explore these developments.*

**W**hile limits on educational spending have considerably reduced the amount devoted to education as a percentage of GNP and of total government expenditure, the savings made have created problems that teachers – who constitute a powerful pressure group – have not failed to point out.

The result of these conflicting pressures is that spending has diminished, but by less than the school population. In other words, average outlays per pupil have continued to rise over the past 15 years in all OECD countries and at all levels except in higher education and, in some countries, secondary schools.

The logical consequence of that should theoretically be that teaching standards have been improved. By increasing the amount of money spent on each pupil, it is possible to reduce the number of pupils per teacher, to accord greater attention to disadvantaged groups or to upgrade school premises. In practice, however, things have not quite worked out like that; above all, there has been a radical shift in the structure of spending on education.

## **Sharp Fall in Capital Spending**

Capital expenditure has been cut dramatically in the majority of countries. In some cases, its share of total spending on

education had fallen to only 5-7 per cent by 1982-83 compared with 20-25 per cent in 1970.

Faced with a large number of unoccupied classrooms (owing to the decline in school rolls), the authorities have tended to reduce maintenance to a minimum and allow school buildings to deteriorate, with damaging consequences for the quality of teaching. That is a short-sighted policy which raises questions regarding the ability of these delapidated premises to meet future needs. Such questions are highly relevant given the foreseeable trends in school populations between now and the year 2000.

## **Salaries Absorb the Bulk of Current Spending**

Current expenditure has considerably increased, on the other hand, at a much faster rate than overall spending on education (except in New Zealand and the United Kingdom). Current spending generally accounts for two-thirds of educational budgets, and half of it goes to teachers' salaries, which have nevertheless tended to rise less rapidly than current outlays as a whole. While the drop in the number of teachers is undoubtedly one reason for that phenomenon, there are others. In particular, there has been a deterioration in the

public image of the teaching profession. It has become increasingly difficult to recruit teachers in certain subjects such as mathematics and physics – fields where industry and the services offer higher salaries.

Nevertheless, the introduction of new technology has increased not only the cost of equipment but salaries as well. Setting up a computer course, for instance, requires both the purchase of the necessary equipment and the recruitment of specialist teachers in addition to the existing teaching staff.

Lastly, in some countries like Austria, Finland, France and Sweden, spending on social services and administration has grown rapidly, which has as a result reduced the relative weight of teachers' salaries.

### Spending Shifts Between Different Levels

There has been a marked shift over the past 15 years in the relative importance of different levels of education – pre-primary, primary, secondary and higher.

- *Increased spending on pre-primary and primary schooling*

Governments have traditionally devoted a substantial share of educational budgets to pre-primary education, as a percentage both of GDP and of total government expenditure. There are two exceptions to that rule – Greece from 1970 to 1976 and Japan between 1976 and 1983. However, except in France and particularly in Belgium, participation rates are still relatively low, and there is room for rapid growth in pre-primary education in almost all countries. In primary schooling, numbers have declined, and the quality of teaching seems to have improved.

- *Secondary schooling has become more expensive*

Secondary education is the most important sector in most countries. It accounts on average for half the share of GNP devoted to education (ranging from 27 per cent in Norway to 54 per cent in France and Germany).

Everywhere except in Austria, Canada, Finland and New Zealand, secondary school rolls increased over the period although spending did not rise commensurately. Hence, there was a decline in the proportion of GNP per head devoted to secondary education in 11 countries, and in another five it did not change. Only in Germany and Denmark did it increase. On the other hand, the average cost per pupil continued to rise in almost all countries, except the Netherlands and New Zealand.

- *Decline in higher education*

While there has been an increase in outlays on other levels in all countries,

## REAL TOTAL PUBLIC EDUCATIONAL EXPENDITURE

As a percentage of real GDP and real total public outlays

	1975		1977		1979		1981		1983	
	GDP	TPO	GDP	TPO	GDP	TPO	GDP	TPO	GDP	TPO
Australia	5.5	18.7	5.7	18.5	5.3	17.8	5.2	18.7	5.8	17.5
Austria	4.9	12.0	4.5	11.1	4.5	10.7	4.7	11.0	4.7	11.5
Canada	7.0	17.5	7.0	18.0	6.3	16.8	6.0	15.9	6.0	n.a.
Denmark	7.0	15.6	6.0	13.9	5.6	11.1	n.a.	n.a.	n.a.	n.a.
Finland	5.8	16.4	6.4	16.7	5.2	13.9	5.1	13.7	5.1	12.9 <sup>1</sup>
France	4.7	11.5	4.6	11.1	4.4	10.2	4.2	9.4	n.a.	n.a.
Germany	4.4	10.1	4.0	9.4	3.9	9.3	3.9	9.1	3.7	9.1
Greece	1.9	6.1	1.9	6.1	2.0	6.4	n.a.	n.a.	n.a.	n.a.
Ireland	5.5	n.a.	5.5	n.a.	5.8	n.a.	5.8	n.a.	5.5 <sup>1</sup>	n.a.
Italy	4.3	10.8	4.5	11.5	4.3	11.3	4.2	11.0	4.2 <sup>1</sup>	10.2 <sup>1</sup>
Japan	4.0	19.0	4.0	18.3	4.2	18.1	4.0	17.7	3.7 <sup>1</sup>	14.8 <sup>1</sup>
Luxembourg	5.2	n.a.	5.1	n.a.	5.0	n.a.	5.2	n.a.	6.1 <sup>1</sup>	n.a.
Netherlands	6.8	14.5	6.5	13.7	6.5	13.1	6.5	12.1	6.2	10.9
New Zealand	5.0	17.4	5.0	16.2	4.6	13.6	4.2	12.2	4.1	n.a.
Norway	6.5	15.0	6.5	14.2	6.1	12.9	6.1	12.8	6.3	13.3
Sweden	6.3	13.0	6.8	12.5	7.6	13.6	7.1	12.0	6.5	11.4
Switzerland	4.8	17.6	4.9	n.a.	4.8	n.a.	4.6	n.a.	4.9	n.a.
United Kingdom	5.8	13.8	5.1	12.7	4.8	12.0	4.7	11.0	4.6 <sup>1</sup>	n.a.
United States	6.2	17.6	5.6	17.3	5.4	16.8	n.a.	n.a.	n.a.	n.a.

1. Or nearest year available.

Source: OECD, *Educational and Economic Statistics*.

The figures on public educational expenditure have been deflated by using the public expenditure deflator.

higher education now accounts for a substantially lower share of educational budgets than it did 10 years ago. The fall in spending cannot be attributed simply to greater efficiency; it also raises the question of the quality of teaching. The situation is particularly surprising in that all countries expressed their concern to train young people in new technologies so as to prepare them for the jobs of the future. That is an expensive business. Starting with the assumption that expenditure has become more efficient while quality has declined, it may well be that there has been a shift from the educational system to the economic system and/or the individual.

Be that as it may, the figures speak for themselves. In several countries, real expenditure per student in higher education as a proportion of GNP per head is now much the same as the corresponding rates for secondary education. In France, it has even fallen below them – to 17.1 per cent as against 18.5 per cent.

- *Private sector becoming increasingly public*

In all OECD countries, the predominant mode of operation is for public funds to finance education provided in public establishments. But almost everywhere education is also provided in private schools, and in many countries they also receive public money in the form of teachers' salaries and/or other types of subsidy.

In some countries, such as the Netherlands for example, the private sector plays an important role, even though it is financed out of public funds. There, private

schools account for the bulk of secondary educational provision and operate in accordance with denominational arrangements enshrined in the Constitution. Elsewhere, the private sector may be very small, if not non-existent. Total public subsidies to private education as a percentage of total educational expenditure ranges from less than 1 per cent in Sweden to almost 65 per cent in the Netherlands.

It is striking that public subsidies increased in all countries except Finland, New Zealand and Sweden over the period. In Japan, for instance, they soared by 315.2 per cent in real terms, almost doubling as a proportion of total public spending on education.

Such growth is hard to explain in the absence of accurate figures for private school rolls. In countries where subsidies are granted on the basis of spending per pupil, the growth in enrolments is a sufficient reason in itself. Where assistance takes the form of teachers' salaries, an improvement in teachers' working conditions may also be a factor. In France, for example, legislative reform has enabled the state to conclude contractual agreements with private schools. The result of that was a 69 per cent increase (at constant prices) in state aid to private schools between 1972 and 1982, even though their rolls grew by only 7 per cent.

An additional reason may have been a shift in subsidies from less costly to more costly educational levels (from primary to secondary, for instance).



*The fall in per-student educational expenditure on higher education cannot be attributed simply to greater efficiency.*

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## Priority to Retraining the Unemployed

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Alongside education in the strict sense, so-called "informal" education is becoming increasingly important, starting from the obvious fact that the education system produces a number of pupils who fail at school and need to be given some additional training to have any real possibility of entering the job market. Side by side with the problems facing unemployed young people looking for their first job, there is also the situation of adults who may be unemployed and in search of alternative employment or who may need to be retrained in new skills corresponding to technological developments.

To meet this demand, a large number of programmes have been introduced which absorb considerable amounts of public funds, mostly outside the control of the formal educational system.

Nevertheless, it is not easy to establish with any accuracy the volume of new spending (as a result of incomplete data, problems of definition, and so on). It is estimated that new spending is equivalent to between 5 and 18 per cent of public outlays on formal education.

There are a variety of sources of funds — central government, local authorities, industry, professional groups, private individuals. It is impossible to find out how

much companies contribute, since their outlays are often recovered in the form of tax relief or other exemptions.

What is certain is that public expenditure on informal education and training has grown rapidly since 1970. In Germany and Ireland, this sector accounts for the same proportion of total spending as higher education. In Japan, its share is greater, while in France, Italy and the United Kingdom it is only about half. The particular features of individual countries' educational systems also have to be taken into consideration in this regard, of course. The German figure, for example, is a result of its dual training system alternating between school and the workplace.

Looking at the two (formal and informal) educational systems together, it is clear that governments spend a lot for what, judging from figures for youth unemployment, appears to be a rather meagre result. Better management of the two sectors, preserving the good organisation of the first and the flexibility of the second, might help avoid this waste.

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## The Search for New Methods of Financing

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The very rigidity of the way public educational systems are financed has facilitated cuts in budget allocations. Most countries use a system in which a large part of funds for education is provided by central or national government out of taxes and borrowings. The funds are transferred to a lower administrative level (state, region, department, local authority, etc.) in

the form of subsidies. Higher education in particular is very dependent on state funds. That is one of the main reasons put forward to explain the deterioration in the situation, since governments make cuts where it is easiest to do so.

As the systems for funding and providing education are generally controlled by central government, questions may arise as to the efficiency of decentralisation measures adopted by countries such as France, Greece and Portugal. It is often the case in fact that where there is a longstanding tradition for education to be provided on a centralised basis by the State (as in those three countries), government may be reluctant to delegate responsibility for education to local authorities. In some cases, it thus looks as though the sole aim of decentralisation is to bring about an increase in local funding without necessarily handing over corresponding decision-making authority. On the other hand, in countries such as the United Kingdom, which have a long tradition of decentralisation, the problem is how to exercise tighter control over funding.

A better balance between central government and local communities would be desirable, therefore. Similarly, some extension of privatisation might be a good idea to the extent that the private sector is at least partially financed out of public funds. Conversely, though, how might private funds be attracted into public education? Various approaches might be considered and are currently under discussion. This is a particularly topical issue in higher education where free provision is often questioned in periods of budgetary austerity. Why, it is asked, should those who benefit from such schooling not pay for it? If the State does have some obligation to provide education, some limits have to be set. In some countries, for example, consideration is being given to replacing the system of grants by a system of student loans or by a mixture of grants and loans, depending on family situation.

Nevertheless, some people are afraid that such changes might have a dissuasive effect on students from poorer families and on women, who earn less than men on average after graduating.

Higher education establishments, and universities in particular, all have the potential for operating as service enterprises and, on certain conditions, for financing a large part of their own expenses through selling their services. That is already happening in the case of research contracts. The remaining costs could be covered jointly by contributions from government, students and industry.

Such a solution naturally implies giving universities real autonomy of financial management, something that is rare in OECD countries at the moment. ■

# Country Problems and Strategies

## The United States

**T**he United States recovery, now well into its fourth year, is one of the longest and strongest since the war. Unlike previous recoveries, inflation has been kept under control. Thus monetary policy could be eased towards late 1984, and this has helped to prolong the upturn. Since mid-1984, however, growth has lost some momentum. Real GNP rose 2<sup>3</sup>/<sub>4</sub> per cent in 1985 and 1986, as against 6<sup>1</sup>/<sub>2</sub> per cent in 1984.

Overall, household consumption has continued to expand faster than the GNP as a result of tax cuts, a strong rise in employment and a fall in the saving ratio, which was down to its lowest level in 40 years (4.5 per cent of GNP in late 1985). But to a large extent the growing consumption has been met by imports and a rundown in stocks, so that it has had little impact on industrial production or manufacturing employment. Industrial production has thus stagnated since mid-1984. The start of an upturn in early 1986 was countered by the cutback in oil drilling and refining, following the drop in oil prices. The growth of business fixed investment has

been faster, stimulated by the private sector's large financial surpluses and the decline in the price of capital goods. The ratio of real gross business fixed investment to GNP rose to a record level of 13 per cent in 1985, before falling back slightly in 1986.

The effect of the upturn in terms of employment has been marked. After reaching a peak of 10<sup>3</sup>/<sub>4</sub> per cent in late 1982, the unemployment rate fell to about 7 per cent in the third quarter of 1986. Unlike its European partners, the United States has shown a remarkable ability to create jobs: 30 million since 1970, and 11 million since 1982. Its superior performance in this respect appears to be related to better functioning of the labour market, i.e. greater labour mobility, more real wage flexibility, wider wage differentials, and fewer legal – regulatory or financial – restrictions as well as a less generous benefit system. Demographic factors are reflected in lower levels of wages for those entering the labour market, an important factor in the strong growth of service employment. This sector at present provides 75 per cent

of total employment and accounted for 95 per cent of the net increase in jobs between 1970 and 1985.

But the recovery involves two aspects of great concern to the United States as well as to the international community: the increase in the federal budget deficit and the deterioration of the external balance. Reducing these two interrelated imbalances is a matter of priority for the authorities in the medium term.

The federal budget deficit increased by 1 per cent of GNP per year between 1982 and 1984, and by a further half per cent in 1985. The net public debt of all levels of government is now at 30 per cent of GNP, or slightly less than the average for the other major countries. But unless corrective action is taken, the gross federal debt would eventually approach 50 per cent of GNP. Up to mid-1984, the greater part of the deficit derived from tax cuts under the Economic Recovery Tax Act, but since then fiscal drag (a tendency for people to move into higher tax brackets as their incomes rise) has raised the effective tax rate. The explanation of the structural deficit is thus to be found elsewhere: defence spending (up 12 per cent per year since 1981), agricultural support, and interest payments on the debt (the latter was up 17 per cent a year since 1981). The growth of debt interest leaves the authorities with little room for manoeuvre for fiscal policy and



*The large U.S. trade deficit is not due to an increase in merchandise imports, which have, in fact, fallen in real terms, but to a decline in exports.*

requires painful cuts in expenditure if an intolerably steep increase in the deficit is to be avoided.

Against this background, 1985 saw two major developments. The August budget resolution achieved agreement on lower defence spending, with the aim of reducing the deficit by half by 1991. In December the Balanced Budget and Emergency Deficit Control Act (known after its sponsors, as the Gramm-Rudman-Hollings Act), which aimed to balance the budget by 1991, with intermediate targets set for the intervening fiscal years, was passed. The President has to submit and Congress has to vote an annual budget consistent with the Act's targets. If no agreement can be reached and the projected deficit exceeds the Balanced Budget Act target by more than \$10 billion, a resolution on across-the-board spending cuts has to be submitted to Congress. Originally, the cost-cutting procedure was to be automatic, but the Supreme Court ruled that this measure was unconstitutional, which makes the law difficult to implement in practice. Nevertheless, the efforts made to correct the medium-term budget situation should be an ongoing incentive to reducing the deficit.

The first spending cuts under the Act were made in March 1986 to bring the 1986 fiscal-year deficit, then projected to be \$220 billion, somewhat closer to the target of \$172 billion set by the Act. Since the projected deficit for 1987 exceeded the target of \$144 billion by \$40 billion, further corrective measures were approved in October 1986. As a result, the official deficit projection (\$151 billion) remains within the accepted margin of \$10 billion set out by the Balanced Budget Act though, on OECD growth assumptions, it could be higher.

The problem of the external position is no less serious. The deterioration has persisted, with a current account deficit of \$107 billion in 1984 and \$118 billion in 1985. The growth of merchandise imports slowed considerably in real terms – from 25 per cent in 1984 to 7 per cent in 1985 – but export volumes fell by 1.7 per cent. Four factors are considered responsible for the external deficit from 1981 to 1985: the deterioration in United States price competitiveness as a result of the dollar's appreciation, the difference in growth between the United States and its major trading partners in the OECD area, lower exports to developing countries, and the decline in net interest receipts reflecting the deterioration of the U.S. net foreign asset position.

The current account deficit (goods and services) may still exceed \$100 billion in 1988 and then, at best, stabilize at this high level.

Exchange rate changes are a powerful

instrument for redressing external imbalances, but the impact of the recent depreciation of the dollar – which is back to its 1985 level – is largely offset by other disequilibrating forces. First, there is a cumulative process between the successive current account deficits and the deterioration in the net external position. The current account deficits from 1981 to 1985 have worsened the net foreign asset position by nearly \$300 billion, turning the United States into a net international debtor for the first time since 1914; the total reduction in United States net foreign assets in the 1980s is likely to be around \$700 billion, with the country's foreign debt reaching some \$500 billion. This would result in a substantial deterioration of net investment income that could be offset only by a decrease in the real exchange rate of the dollar, resulting in an improvement in United States' international competitiveness.

Secondly, if the United States growth rate still exceeded that of its partners, the part of the deficit due to this situation would be maintained indefinitely. Moreover, the deficit would continue to widen if growth of imports still exceeded that of exports. In addition, debtor countries will endeavour to reduce their imports for a long time to come.

Lastly, the cost-price competitiveness of the United States does not seem to have recovered much vis-à-vis the most industrialized developing countries in South-East Asia and Latin America. Rather than a net reduction of total imports, this may result in a shift of United States imports away from the OECD area and towards Hong Kong, Singapore, South Korea and Taiwan.

The current account deficit could not be sustained if rising net imports were to result in irresistible protectionist pressures. The exchange rate initiative of the Group of

5 to encourage a fall in the dollar has made it possible to reduce such pressures, at least temporarily. As long as the capital inflows required for the financing of the deficits are forthcoming at the prevailing exchange rate of the dollar, these same deficits will not appear unsustainable.

But certain observers emphasize the persistent attractiveness for foreign investors of the United States economy in general and of the United States' financial markets in particular – because of their size, diversification and liquidity; if need be, a small rise in interest rates could be sufficient to attract them.

Other observers are more doubtful that the rest of the world will be willing to absorb United States assets indefinitely, as was the case in recent years because of a unique combination of one-off events: on the United States side, tax reform and deregulation; on the external side, the debt crisis in developing countries and relaxation of controls on capital outflows in several countries. The desire to diversify and acquire foreign assets is becoming a worldwide trend, but certain portfolios may already have a sufficient share of United States assets, particularly in Japan. Moreover, investors will keep these assets only if they offer higher returns relative to shares denominated in other currencies. But with the present emphasis on reducing the budget deficit, United States interest rates seem more likely to decrease than to rise. Trends in the dollar and interest rates will therefore be of vital importance for the future of imbalances.

The twin tasks of unwinding the United States' domestic and external imbalances are likely to involve difficult, and at times risky, policy choices. The chances of success could no doubt be enhanced by continued efforts towards greater international co-ordination of policies among the major countries.

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## Japan

**J**apan's economic growth has weakened. The latest OECD projections suggest an increase of only 2¼ per cent for 1986, the lowest in a decade. Because of the higher yen and weaker export markets, the volume of exports fell in 1986 after growing by over 25 per cent between 1983 and 1985. What problems are these developments going to create for the Japanese labour market?

An unusual feature is that Japan went through the economic crises of the 1970s without any serious employment imbalances. Although unemployment almost tripled during the last decade, to almost 3 per cent by the end of 1986, the situation is still more satisfactory than in any other major OECD country. Also, the average duration

of unemployment is shorter (2.1 months in Japan in 1982, the most recent available figures, as against 4 months in the United States and Canada and 8 to 13 months in Germany, the United Kingdom and France); long-term unemployment mainly affects older workers.

Certain special features of the Japanese labour market help to explain this situation. One is the well-known lifetime employment system. Firms recruit their workforce from new graduates each year, give them long-term training to match the firm's requirements and assure them of employment until retirement (usually at 55 but, by 1985, 51 per cent of all firms had opted for retirement for their employees at the age of 60.) Compensation is based on seniority;

hence it is low at the start of a career but several times higher later on. Because of this system and also for demographic reasons, youth unemployment is a much less serious problem than in the other OECD countries.

Lifetime employment practices are to be found throughout the economy, in firms of all sizes, but most often in larger ones. The system generates a remarkable degree of *internal mobility* since workers accept changes in job content and location in exchange for the security offered. Furthermore, because mid-career recruitment is rare, workers remain attached to their firms. Older men, women, part-time or temporary workers are much more mobile as between firms, and the female labour force is especially flexible. On the one hand, few women enjoy lifetime employment since they often cease work at marriage or upon the birth of their first child. On the other hand, an increasing number of women are combining household responsibilities with part-time work. The expanding tertiary sector is taking advantage of such arrangements to acquire a workforce that can adapt to the ups and downs of business. Part-time work has the advantage for the firm of lower hourly costs because employers make lower insurance contributions, grant less paid leave and give no bonus payments. More generally, the lack of stringent government regulations permits greater flexibility than in other countries.

The sub-contracting system also plays an important role in adjustment during a recession. Half the labour force is employed by small firms (less than 100 employees), usually at lower wages than in large ones. When demand falls, large firms cut back on orders placed with sub-contracting firms, and the subcontractors tend to increase productivity and limit wages so as to avoid bankruptcy. In other words, small firms bear a large share of the costs of adjustment. This trend has been strengthened in recent years by the devolution to sub-contracting firms of many of the service functions in manufacturing firms.

The system of enterprise-based trade unions also helps to ensure that wages will adjust. Since they are not based on occupation or industry, but on individual firms, Japanese trade unions are very concerned about the implications of wage claims for the profitability of their firms. Wages are set for the year during the "Shunto", the annual spring wage round. This process leads to flexibility, especially in terms of real wages which balance the supply of labour against that of available jobs. However nominal wages are not necessarily flexible downwards: the seniority system not only ensures cooperation within the firm; it also implies wage increments of 1½ to 2 per cent a year. With the economic



crisis, company performance has become the main determinant of wages; comparability with other employers, the need to retain labour or the wish to ensure higher purchasing power have become less important. Minimum wages are set each year by a public council composed of both employers and employees. It takes into account results of the "shunto" and also labour market conditions, thereby achieving a consensus.

The wage payment system is more flexible in Japan than in Europe, as surveys confirm. The gap between real "warranted" wage growth (i.e. higher wage increases due to labour productivity growth, adjusted for terms of trade changes) and *actual* real wage growth has narrowed since 1975. Until 1979, the squeeze on profits was offset by the slow rise in real wages (2.2 per cent annually) which was well below the growth in productivity. From 1979 to 1983, low growth in real wages (only 0.7 per cent) also offset the loss in terms of trade due to the second oil shock. Since then, real wages have grown by about 2 per cent a year, allowing an increased share for profits. Wage flexibility is also reflected in pay differentials between sectors, which are much wider in Japan than in most European countries (but

*Japan's good employment record should not obscure longer-term problems, notably the ageing of the labour force which is still relatively young compared to other countries.*

close to those of the United States and Canada).

Another component of flexibility is non-wage labour costs, which are low in Japan. In 1983, employers' mandatory contributions to social security schemes accounted for 7.5 per cent of employee compensation, well below that of most OECD countries (but slightly more than in the United States and the United Kingdom where private insurance schemes are more important). There are also contributions to private insurance schemes in Japan, and these go mainly towards retirement allowances (5.1 per cent of employee compensation) and more training, housing and leisure facilities. However, these elements are perceived as a form of compensation and therefore do not introduce rigidity in the same way as mandatory contributions in continental European countries do.

Slower adjustment of unemployment to cyclical trends may be explained by the greater importance of overtime (13 per cent of total hours worked by an average production worker) and by the retention of

employees by large firms. Furthermore, the labour supply itself is cyclically sensitive, especially the supply of female labour, at least until quite recently. The number of "discouraged" workers (i.e. those who would like a job but are not actively seeking one because they do not think they could find one) seems particularly large: about 2 million in 1980.

Japan's favourable economic situation also contributed to its good employment performance. In the last decade, growth of demand was greater than in any other major OECD country and, throughout this period, the investment ratio stayed high, facilitating a major structural transformation, particularly in manufacturing. Even those industries hardest hit by rising energy costs and competition from Asian NICs managed to adjust by boosting productivity. Diversification, along with internal labour mobility, played an important role. As in all industrialized countries, the tertiary sector grew, but with one distinction: more of it was in the private sector than in public service.

Several government employment and unemployment measures have been introduced. First, the legislation on redundancy is similar to that in force in Europe, but its impact is limited by the lifetime employment system. Secondly, under a 1975 Act, amended on various occasions, an "Employment Stabilization Fund" was set up for employers who put redundant workers on temporary paid leave, give them paid training or transfer rather than dismiss them. Furthermore, an income maintenance scheme supplies moderate benefits. In order to prevent perverse effects, the length of the benefit depends on how long the worker has belonged to the system. At the same time, a special premium has been introduced for those who find a job well before the termination of their benefit period. OECD estimates, based on national accounts, suggest an average income replacement percentage for unemployed workers of 32 per cent in Japan, more than in the United States (17 per cent), Italy (18 per cent) or the United Kingdom (27 per cent) but lower than in France (34 per cent) or Germany (48 per cent).

Japan's success in avoiding any serious labour market disequilibria should not obscure the problems that may lie ahead. Over the longer run, the central problem is no doubt the ageing of the labour force. During the 1980s, the annual population growth rate is likely to be 3.7 per cent for those aged 55 to 64, as against only 0.9 per cent for those aged 15 to 64. The female participation rate is also likely to grow further. Moreover many of the arrangements that have given the Japanese labour market its renowned flexibility during the last difficult decade or so are not always popular with those directly

affected. In many ways, there has been a marked deterioration in the *quality*, if not the quantity, of jobs offered. The conditions of women, the precarious job tenure and insufficient hours of part-time and other workers and the situation of men over 55 and "dispatched" workers have led to increased pressure for protective legislation. The government has recently enacted or prepared various legislative or administrative measures to enhance protection of some specific groups of employees.

So far, labour markets have always adjusted to successive external shocks. Although, under the lifetime system, a significant proportion of the labour force enjoys better guarantees of employment than in most other Member countries, this security has not engendered rigid resis-

tance to change. Rather, it has encouraged the degree of adjustment necessary to preserve jobs in a highly dynamic and competitive economy. As a result, wage costs have demonstrated a high degree of flexibility in relation to productivity developments as well as within industries. Relatively free labour markets have also provided a vast array of jobs (particularly part-time jobs) that have helped keep unemployment low and rather stable. Even though certain specific features of the Japanese labour market, demographic factors, as well as deep-rooted socio-cultural attitudes, not transferable elsewhere, have no doubt played an important role, Japan's experience may offer lessons for other Member countries with rigid and over-regulated labour markets.

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## Belgium

**B**ecause of the exceptional openness of its economy, Belgium has been more vulnerable than its partners to the successive crises that have occurred since 1973. While its economic performance before the first oil shock was very satisfactory, imbalances subsequently built up more rapidly in Belgium than in most other OECD countries up until the early 1980s. Despite the progress made since then, the economy has not advanced far along the road to recovery.

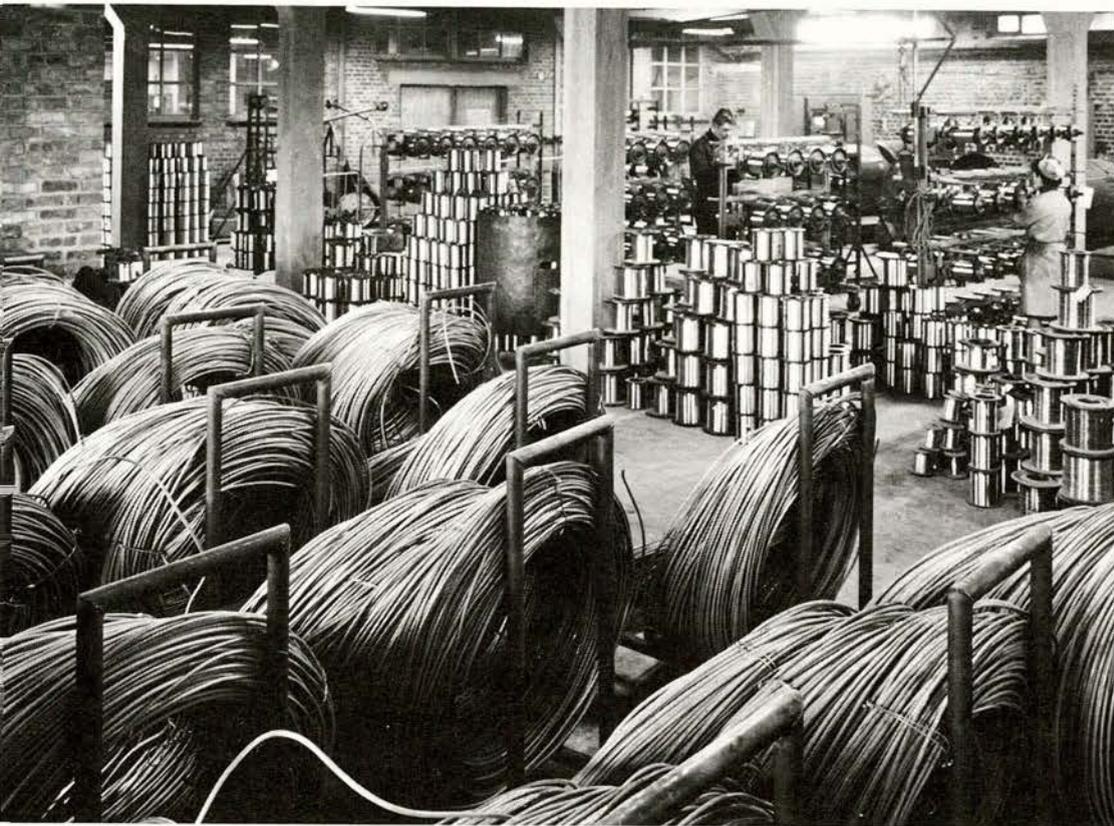
The most serious imbalance is in public finance, with a treasury deficit amounting to 12 per cent of GDP in 1985. The recovery programme introduced in 1984 set a target of 10.2 per cent for 1985 (the first stage of a three-year plan for reducing the deficit by the equivalent of over 6 per cent of GDP) but that was not achieved because of a shortfall in receipts and a growing deficit in cash transactions. The public finance overshoot was accompanied by a rapid accumulation of debt; general government debt had risen to more than 120 per cent of GDP by 1985, one of the highest rates in the OECD area. As a result, interest charges have increased (from 8.5 per cent of GNP in 1981 to 11.1 per cent in 1985), so that the deficit has become self-perpetuating. Some progress has been made, however, since there was a slight budget surplus (of 0.75 per cent of GDP) before interest payments in 1985 compared to a deficit of 6 per cent of GDP in 1981. That is far from satisfactory, though, and a new recovery programme was presented to Parliament in May 1986 which builds on the earlier one but takes it a stage further. The new target is to bring the Treasury borrowing requirement down to 8 per cent of GDP in 1987 and to 7 per cent in 1989 by means of a modest increase in government revenue (of 5.5 per cent between 1985 and 1987) and sub-

stantial spending cuts (of 2.4 per cent at current prices).

Another major structural imbalance is the labour market, with an unemployment rate of 12 per cent in August 1986. Although that is one of the highest rates in the OECD area, it has nevertheless declined from its peak of 13 per cent in 1984. That is due to a very positive policy of supporting employment, pursued since 1983, including a work-sharing scheme, a public sector work orientation programme and a rapid increase in part-time employment encouraged by the provision of supplementary benefits to unemployed people who accept part-time work. Measures have also been taken to reduce labour supply. Even so, not only is the level of unemployment still high, but its composition is disturbing: two thirds of the jobless have been out of work for over a year and 32.4 per cent of all unemployed people are under 25.

While the current account has continued the improvement begun in 1982, and showed a small surplus in 1985, that was attributable more to the weakness of domestic demand growth than to healthy export performance. Manufacturing industry suffered a further erosion of its share of foreign markets in 1985. Belgium's export performance is indicative of its industry's difficulties in responding to the dual challenge of maintaining cost and price competitiveness and adapting to rapid changes in international demand.

That is particularly serious in a country like Belgium whose manufacturing industry plays a key role in the economy. Although its share of GDP has fallen by nearly seven percentage points over the past 10 years, while that of the service sector has increased, manufacturing still accounted for 24.3 per cent of GDP in 1983, compared to 57.7 per cent for service and 18 per cent for the primary sector. Its



*Belgian industry has concentrated on low- and medium-technology goods in which it has had a comparative advantage rather than on competitive high-tech products.*

composition changed radically during the 1970s, especially in the aftermath of the first oil shock. Belgian industry has sought to achieve economies of scale through developing low- and medium-technology sectors where it enjoys a substantial comparative advantage in world markets, at the expense of high technology industries. There has been a shift away from sectors hit by the slowdown in world demand (metals and minerals) towards chemicals, pharmaceuticals and medical products where trade clearly plays an important role.

The main feature of Belgian industry is its openness to the outside world. In 1984, the total value of imports and exports was equivalent to 150 per cent of GDP, putting it in second place in that respect behind Luxembourg among OECD countries (although it ranked only fifth in 1960). Manufacturing goods account for 80 per cent of merchandise trade and generated a relatively stable surplus of 30 per cent of value added up to the first oil shock. Then, because of the combined effect of a surge in imports and mediocre export performance, that surplus narrowed to only 17 per cent in 1980. Since then, there has been some improvement, with the surplus reaching a record 33 per cent of value added in 1983-84 because of the slowdown in import growth. However, analysis shows that value added has decreased in

Belgium, especially between the two oil shocks, because industry has had difficulty in passing on price increases on imported goods, of which it absorbs a large volume. That reflects not only Belgian industry's dependence on foreign trade but also its inability to influence price levels in export markets.

The problems of Belgian industry are partly due to the structure of its exports. They are oriented towards markets (mostly in Europe) where growth has slowed more than elsewhere since the late 1970s. Furthermore, Belgian exports still continue to be concentrated in sectors where demand in world markets remains weak or depressed. Products in which Belgium still enjoys a comparative advantage thus tend to be ones for which there is little growth potential.

Low profitability and resurgent financial problems have inhibited the structural adjustment that Belgian industry badly needs to implement. There are two main reasons for that. In the 1970s real labour costs increased more rapidly than productivity. Companies chose to substitute capital for labour rather than to expand production capacity, and the investment rate was not only lower than in other countries but actually fell by 5.7 per cent a year on average. There was a significant increase in apparent labour productivity as a result of a 30 per cent fall in employment, especially in sectors hit by falling demand. During that period, the profitability of Belgian manufactured exports was sharply squeezed by high and growing labour costs while relative export prices were stable or falling. A stable exchange rate policy

served to compound the problem of competitiveness, and the increasing gap between Belgian and world market interest rates led business to look for productivity gains. Margins were reduced and, as the tax rate on profits was increased at the same time, corporate profitability declined. Companies fell heavily into debt and were faced with growing interest charges.

After 1980, the effective depreciation of the Belgian franc and falling relative labour costs led to a fall in dollar export prices. Firms' financial positions improved under the effect of a gradual easing of corporate taxation and the introduction of incentives for financial restructuring. Between 1979 and 1982, there was a brisk, although temporary, pick-up in investment.

The government's industrial policy, which fell into disarray following the first oil shock, has increasingly been geared to assisting industries in difficulty. Government support, in the shape of subsidies, capital transfers, loans and equity investments, has been directed mainly at the public sector (especially transport and housing) and the so-called national industries (steel, coal, textiles and glass containers). Most aid has been for investment purposes (75 per cent of the total) with the dual aim of encouraging sectoral restructuring and bringing about a better regional balance. These measures have only induced a very limited diversification of industry, however, and have been of little help to the private sector (apart from the "national" industries which have benefited from large injections of public funds to finance structural adjustment programmes, with two thirds of the funds being off-budget). Steel has been the primary beneficiary, enabling it to adjust its production capacity and expand its capital investment at a faster rate than the European average.

Over the past few years, the emphasis has been laid less on direct state intervention than on the creation of economic conditions favorable to the business sector through the use of appropriate macro-economic policies. These policies have comprised three main planks: to curb the growth of wage costs, to promote greater labour market flexibility and to improve the corporate sector's financial position. The third of these policy aims has entailed an easing of the tax burden and the introduction of incentives for raising equity capital so as to reduce debt and interest charges and to restore profitability. However, while appropriate macro-economic policies can help in the essential task of creating new industries, the ultimate responsibility in that respect remains with the private sector. A greater general adjustment effort by European industry as a whole would also help Belgian industry close the structural gap with its partners. ■

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# *Highlights from* **the OECD Economic Outlook** *December 1986*

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## **Reducing External Imbalances While Maintaining Growth**

Growth in the OECD area in the first half of 1986 was slower than expected. This has not, however, affected the broad judgement that the falls in oil prices, combined with the exchange-rate changes and interest-rate declines since mid-1985, have enhanced the prospect for sustained, though moderate, growth at low rates of inflation. OECD activity is projected to expand at annual rates of 2½ to 3 per cent over the next eighteen months. Employment should continue to increase, but so should the labour force: there may be little change in the average OECD unemployment rate. Appreciable adjustment of export and import volume trends is getting under way, though only a limited reduction is foreseen in large current-account imbalances measured in dollars or as shares of GNP. The international debt situation continues to be contained, but remains fragile.

Against this background, the main task facing policy is still the unwinding of the international imbalances while maintaining low inflation and strengthening the momentum of output and employment growth. There is a danger that impatience with the pace of reduction of large surpluses and deficits could provoke disorderly exchange-market conditions or lead to intensified protectionist pressures. Either of these could impair the strength of world growth. It is therefore important for national authorities to agree – and to be seen to agree – on the international requirements for adjustment over the medium term, and to pursue the policies which flow from these. An important element here is the achievement of significant differences across countries in growth rates of domestic demand, while maintaining an adequate expansion of activity in the OECD area as a whole. All countries can strengthen growth and employment trends by persisting with – and in some areas stepping up – efforts to improve the structures and flexibility of their economies.

### *Unwinding external imbalances*

Major current account imbalances remain a key macroeconomic problem facing OECD countries (Table 1). Failure to correct them in a smooth manner could jeopardise growth, high employment and price stability.

At the Plaza Group of 5 meeting of September 1985, the pattern of current account balances arising from the prevailing configuration of policies and of exchange rates in the largest countries was recognised as unsustainable. Since then, there has been progress in creating conditions conducive to current-account

adjustment. On an effective (trade-weighted) basis, the dollar has reversed nearly all of its rise between 1980 and 1985 against other OECD currencies. The U.S. budget deficit appears set for a significant structural reduction in 1987, even if the outlook for subsequent cuts is not clear. And prospective relative growth rates of domestic demand among major countries should begin to be supportive of adjustment.

The main elements in the OECD assessment of current account developments are:

- The dollar's fall has been particularly marked against the currencies of Japan and Germany, the two OECD countries with very large surpluses. The dollar has

not fallen *vis-à-vis* the currencies of a group of South-East Asian countries with strong external positions; however, taking account of trade patterns, the implications of this for the prospective improvement of U.S. trade performance are limited;

- Thus far the terms-of-trade changes that normally accompany large shifts in exchange rates have been attenuated, particularly for the United States. Exporters to the United States appear to have absorbed much of the initial phase of the depreciation of the dollar on profit margins, rather than passing it fully into U.S. import prices (broadly reversing the unusual widening of profit margins when the dollar appreciated). Hence the

## 1. CURRENT BALANCES OF OECD COUNTRIES

\$ billion, seasonally adjusted, at annual rates

	1984	1985	1986	1987	1986		1987		1988
					I	II	I	II	I
United States	-106.5	-117.7	-138	-136½	-137.5	-138¾	-137¾	-135	-133½
Japan	35.0	49.2	81¾	77¼	74.9	88½	80½	74¼	72¼
Germany	7.0	13.2	32½	26¼	30.5	34¼	29	23¾	20¾
France	-0.8	-0.2	3¾	2¼	3.4	4¼	3	1¾	¾
United Kingdom	2.1	4.6	-¼	-4¾	2.8	-3¼	-3	-6¼	-8¾
Italy	-2.9	-4.2	4¾	2½	3.0	6½	3½	1½	-¼
Canada	2.6	-0.4	-6¾	-5¾	-6.7	-6½	-6¼	-5	-3½
Total of above 7 countries	-63.5	-55.5	-22¼	-38¼	-29.8	-15	-31½	-45	-52¼
Other OECD countries	-2.3	-2.0	2¾	4¼	-2.2	7½	4	4½	5
<b>Total OECD</b>	<b>-65.8</b>	<b>-57.5</b>	<b>-19¾</b>	<b>-34</b>	<b>-31.9</b>	<b>-7½</b>	<b>-27½</b>	<b>-40½</b>	<b>-47¼</b>
Four major European countries	5.3	13.5	40¾	26½	39.6	42	32½	20½	12½
OECD Europe	13.1	21.2	54½	40	48.9	60	46	34	26¼
EEC	7.1	16.1	51¾	39¼	48.0	55½	44½	34	28
Total OECD less the United States	40.6	60.2	118½	102½	105.6	131¼	110½	94½	86¼

### Other OECD Countries

	1984	1985	1986	1987
Austria	-0.2	0	0	-¼
Belgium-Luxembourg	0	0.8	3¾	4¾
Denmark	-1.6	-2.7	-4¼	-2¾
Finland	0	-0.8	-¾	-1
Greece	-2.1	-3.3	-1¾	-1¼
Iceland	-0.1	-0.1	0	0
Ireland	-0.9	-0.6	-½	-½
Netherlands	5.0	5.2	7¼	6¼
Norway	3.0	3.0	-4¾	-6
Portugal	-0.6	0.4	1¾	1¼
Spain	2.0	2.7	4¾	5¼
Sweden	0.4	-1.2	1¾	1½
Switzerland	4.4	5.2	7¾	7¾
Turkey	-1.4	-1.0	-1¼	-1¼
Total of above European countries	7.7	7.7	13¾	13½
Australia	-8.5	-8.6	-9¾	-8¼
New Zealand	-1.6	-1.1	-1¼	-1
Total of above 17 countries	-2.3	-2.0	2¾	4¼

effects on the competitive position of U.S. producers *vis-à-vis* imports have been limited as, in consequence, have been the effects on U.S. import volumes. With the depreciation continuing, there has been less scope for reducing margins on exports to the United States; both dollar price increases and consequent volume effects should now become more apparent;

- As economies adjust more fully to the new pattern of relative costs, the adjustments in volume terms, as measured by real foreign balances, are likely to be significant. For the next eighteen months or so, GNP may grow steadily ½ point faster than domestic demand in the United States, 1 point more slowly than

domestic demand in Japan and more than 1 point more slowly in Germany;

- Reduction of nominal current account imbalances is likely to be slow, particularly for the United States and Japan. Part of the terms-of-trade changes arising from recent exchange-rate swings has still to come through. As well, reduction of nominal imbalances is slowed because these imbalances are so large (see table below): in the United States exports must grow much more rapidly than imports simply to maintain an unchanged deficit, while the reverse is true for countries in large surplus.

### Current balances as a percentage of GNP

	1985	1986	1987	1988 I
United States	-2.9	-3.3	-3.0	-2.9
Japan	3.7	4.2	3.7	3.3
Germany	2.1	3.6	2.6	2.0

In summary, recent exchange-rate changes can be expected to contribute to the reduction of external imbalances of major OECD countries. They are also likely to have further beneficial effects beyond the short-term horizon. Whether they will be sufficient to bring current balances back to "sustainable" ranges is, however, difficult to judge. The difficulty arises partly because the notion of sustainability is not precise, and partly because substantial and *lasting* exchange rate changes might ultimately have larger effects than conventional estimates of price elasticities of trade would suggest.

Allowing for the uncertainties, it nevertheless seems likely that, *over time*,

there will be need for further adjustment beyond what would result from the continuation of present policy settings and exchange-rate relationships. If the U.S. budget deficit is reduced over the medium term broadly as called for by the Gramm-Rudman-Hollings Act, this would set in motion forces that should bring about a significant lowering of the current-account deficit. Further exchange rate changes over the medium term would strengthen the adjustment process. And greater divergence in growth rates of domestic demand across countries, beyond what might result from U.S. fiscal action, would also contribute to better balance.

Discussion of differential growth of domestic demand inevitably raises issues of the relative contributions of the United States and other OECD countries to the medium-term correction of imbalances. Several points are worth making:

- Reduction of the U.S. budget deficit would have the short-term impact of reducing domestic demand growth. This damping of activity would be offset to some extent by the relief on long-term interest rates which should accompany the declining budget deficit. GNP growth in the United States would also be boosted insofar as net exports improved. On balance, there may nonetheless be some weakening of output growth; attempts to offset this by a marked easing of U.S. monetary policy would, however, carry a risk of higher inflation and interest rates;

- It is important for any policy-induced slowing of U.S. domestic demand growth to be brought about through fiscal tightening, which would tend to expand the flow of saving available for investment and reduce interest rates, rather than through monetary tightening, which would tend to increase interest rates and crowd out investment;

- Regarding activity in countries other than the United States, the primary focus should be less on its potential effects on U.S. external adjustment – which might be relatively modest – and more on ensuring that the growth of domestic output is adequate relative to a sustainable non-inflationary path, taking account, *inter alia*, of possible weakness of exports arising from slower U.S. growth.

With full adjustment almost certain to take a number of years, there is a continuing risk that, as a result of a pace of adjustment that is seen as slow or inadequate, large and disorderly exchange-rate changes might occur, or that protectionism will become increasingly difficult to resist. But authorities are faced with a dilemma here, because of the likely costliness of attempts to speed

## 2. GROWTH OF REAL GDP/GNP IN THE OECD AREA<sup>a</sup>

Percentage changes from previous period, seasonally adjusted at annual rates

	1982 Share in total OECD	1984	1985	1986	1987	1986		1987		1988 I
						I	II	I	II	
United States	41.1	6.4	2.7	2¼	3	2.6	2¼	3¼	3	3
Japan	14.2	5.1	4.5	2¼	2¾	1.1	2¼	3	2½	3¼
Germany	8.0	3.0	2.5	2¾	3	0.6	5¾	2½	2	2
France	7.1	1.5	1.4	2	2¼	1.3	2¼	2¼	2¼	2
United Kingdom	6.3	3.0	3.5	2¼	2¾	2.3	3	2¾	2½	2
Italy	4.5	2.8	2.3	2½	3	2.0	3¼	3	2¾	2½
Canada	3.9	5.5	4.0	3	2¾	3.6	1½	3¼	3¼	3¼
Total of 7 above countries	85.2	5.0	3.0	2½	2¾	2.1	2½	3	2¾	2¾
Other OECD countries <sup>b</sup>	14.8	3.3	2.9	2¼	2¼	2.0	2¾	2¼	2¼	2¼
<b>Total OECD</b>	<b>100.0</b>	<b>4.7</b>	<b>3.0</b>	<b>2½</b>	<b>2¾</b>	<b>2.1</b>	<b>2½</b>	<b>3</b>	<b>2¾</b>	<b>2¾</b>
Four major European countries	25.9	2.6	2.4	2½	2¾	1.5	3¾	2½	2¼	2¼
Total OECD less the United States	58.9	3.6	3.2	2½	2¾	1.6	3	2¾	2½	2½
Industrial Production : Major seven countries	—	9.0	2.9	1	2½	0.2	1½	2½	3	3
Total OECD	—	8.4	2.9	1¼	2½	0.5	1¾	2¾	3	3¼

### Other OECD Countries

	1982 Share in total OECD	1984	1985	1986	1987
Austria	0.9	2.0	3.0	2¼	2½
Belgium	1.1	1.3	1.1	2	2
Denmark	0.7	3.4	3.8	2¾	½
Finland	0.5	2.8	2.8	1½	2
Greece	0.5	2.8	2.1	0	-½
Iceland	0	3.2	2.8	5½	2
Ireland	0.2	1.8	0.2	1½	2
Luxembourg	0	4.9	1.9	2¼	2½
Netherlands	1.8	2.3	1.8	1½	1½
Norway	0.7	5.6	4.2	4¼	2
Portugal	0.3	-1.5	2.8	4¼	3½
Spain	2.3	2.2	2.1	3	3¼
Sweden	1.3	3.4	2.3	2¼	1¼
Switzerland	1.3	1.6	4.0	2	1¾
Turkey	0.7	5.9	5.1	7¾	5
Total of above European countries	12.4	2.7	2.7	2½	2¼
Australia	2.1	6.9	4.4	1¼	3¼
New Zealand	0.3	5.1	1.2	-¾	½
Total of above 17 countries	14.8	3.3	2.9	2¼	2¼

a) Aggregates were computed on the basis of 1982 exchange rates.

b) Half-yearly data must be interpreted with care since for fourteen 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.

up current-account adjustment in the short term. It might, for example, be difficult in the short run to bring about wider differentials in domestic demand growth between countries without a lowering of average growth rates for the OECD as a whole: reorienting activity towards and away from tradeable goods sectors is a slow process. Fiscal and monetary policies could support these

processes, but they might not be able to force the pace without endangering hard-won gains on inflation and medium-term budgetary objectives. It could also be argued that, whatever exchange-rate changes might be required over the medium term, a "pause" would now be desirable for a time. Indeed, this would appear to be one of the considerations underlying the recent agreement between the United States and Japan. The case for an exchange-rate pause is based largely on the problems of "digesting" the effects of rapid currency movements – the boost to the price level in depreciating countries, the contractionary effects of demand in appreciating countries, and the tensions associated with rapid changes in relative prices in both groups of countries. In addition, there is considerable uncertainty about the ultimate size of the effects of the large exchange-rate changes that have now occurred.

Such a pause, even if generally thought desirable, might not be easy to bring about. There are limits to what could be achieved with exchange-market intervention, though a "signal" from the authorities at the appropriate moment could have an effect on exchange-rate expectations and behaviour. More generally, the main instrument for influencing the exchange rate in the short term would seem to be monetary policy. But this instrument is already heavily committed on the domestic side, given that the needs of budget consolidation have made fiscal policy largely unavailable as an instrument of stabilization policy in many countries. Nonetheless, setting monetary

policy in most countries is routinely a matter of striking a balance between domestic and exchange-rate considerations, and there might be room for that balance to be tilted towards giving more weight, in the short term, to stabilizing exchange rates. Such an approach would call for close international cooperation if the monetary growth in the largest countries were to be kept at rates consistent with maintaining low inflation and sustainable growth for the area as a whole.

### The short-term prospects

Resolving the problem of international imbalances, though necessary, does not guarantee that economic performance more generally will be satisfactory. The major forces likely to be at work over the next year or so seem to be making for continuing recovery at low rates of inflation but with little change in unemployment.

It was envisaged in the last *Economic Outlook* that the sharp fall in oil prices would give rise to both positive and negative influences on OECD output growth, with the former predominating. In the event, as oil revenues fell, there have been substantial cuts in the imports of oil-exporting non-OECD countries and in energy-related investment in OECD countries. Moreover, further investment cutbacks are likely if present levels of oil prices persist. Furthermore, oil-exporting non-OECD countries will need to continue to adjust to lower export revenues; additional cuts in the imports of most of these countries are expected through 1987 and into 1988. Countries hit by the weakness of non-oil commodity prices, which was more pronounced than expected, have also had to reduce their imports in line with weaker earnings.

On the side of the "winners" from oil price falls, the speed of adjustment has been noticeably slower, and substantial positive effects on activity are yet to be realized. The timing, and possibly the ultimate size, of the oil-price impact on activity will be determined by the extent of the pass-through of energy price falls to the private sector and the split of the private sector gains between households and firms. In some countries, lower fuel prices were translated quickly and rather fully into lower consumer prices. In others, the pass-through has been less complete – either because energy taxes were raised, thereby channelling part of the terms-of-trade gains towards reduction of public sector deficits, or because regulated energy prices were not reduced in line with falling primary energy costs. In most countries, private sector profits have risen. ▶

### 3. PRIVATE CONSUMPTION DEFLATORS IN THE OECD AREA<sup>a</sup>

Percentage changes from previous period, seasonally adjusted at annual rates

	1984	1985	1986	1987	1986		1987		1988
					I	II	I	II	I
United States	3.8	3.5	2¼	3	1.4	2¾	3¼	3½	3½
Japan	2.1	2.2	¾	0	0.7	-¼	0	½	½
Germany	2.5	2.1	-¾	¾	-1.4	-½	1	1½	1½
France	7.2	5.5	2¼	2	0.9	2½	2	1¾	2
United Kingdom	4.8	5.2	4	4½	3.7	3½	4¾	4½	4¾
Italy	11.1	9.4	6¼	4	6.4	4	4	3¾	3¾
Canada	4.4	4.1	4	3¾	4.0	3½	3¾	3½	3½
Total of 7 above countries	4.2	3.8	2	2½	1.5	2	2½	2¾	2¾
Other OECD countries <sup>b</sup>	9.8	8.6	6¾	5¾	6.7	6¼	5½	5¼	5
Total OECD	5.0	4.5	2¾	3	2.3	2¾	3	3	3
Four major European countries	5.8	5.0	2½	2½	1.8	2	2¾	2¾	2¾
Total OECD less the United States	5.8	5.2	3¼	2¾	2.9	2¾	2¾	2¾	2¾

#### Other OECD Countries

Percentage changes

	1985	1986	1987
Austria	3.4	1½	2
Belgium	5.0	1¼	1¼
Denmark	4.7	3½	3¾
Finland <sup>c</sup>	6.0	3¼	3¼
Greece	18.6	22¼	13½
Iceland <sup>c</sup>	32.5	20½	12¾
Ireland	4.2	4	3½
Luxembourg	4.1	1	1½
Netherlands	2.6	0	-½
Norway	5.8	7¼	8
Portugal	19.8	12	9½
Spain <sup>c</sup>	8.8	8½	6¼
Sweden	7.2	4½	3¾
Switzerland <sup>c</sup>	3.6	¾	1¼
Turkey	45.5	32	30
Total of above			
European countries	8.7	6¼	5¼
Australia	7.3	9¼	7¼
New-Zealand <sup>c</sup>	15.2	13¼	10½
Total of above			
17 countries	8.6	6¾	5¾
Total OECD	4.5	2¾	3

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 fourteen 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.

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

OECD domestic demand is projected to expand through 1987 and into 1988 at an annual rate of close to 3 per cent. Taking account of the adverse effects of persistent weakness of demand from non-OECD countries, real GNP of the OECD area may grow at annual rates of 2½ to 3 per cent throughout the period (Table 2). The risks attaching to the projections may be unevenly spread across the OECD area. Activity in Europe could, if anything, be stronger, but a weaker outcome appears possible in both the United States and Japan.

Inflation rates – and quite possibly inflation expectations – in OECD coun-

tries are at their lowest for twenty years, as the effects of disinflationary monetary policies of the early 1980s have been reinforced by the recent falls in oil and other commodity prices. Medium-term prospects for inflation are also affected by continuing high unemployment in OECD countries as well as by the inertia in the inflation process (often a source of concern to policy-makers in the past when inflation was high). After the immediate effects of the falls in oil and non-oil commodity prices have worked through, OECD inflation is likely to be running at some 3 per cent (Table 3).

Prospects are less favourable both for unemployment within the OECD and for growth in many countries outside it. *Employment* in the OECD area is likely to continue to grow moderately (by 1¼ per cent in 1986 and 1 per cent in 1987); but since this rate of growth is unlikely to exceed that of the OECD labour force, the overall OECD rate of unemployment may remain at about 8¼ per cent, where it has stood since 1984 (Table 4). Sustained unemployment at this rate (over 31 million people in 1987 and the first half of 1988) remains a fundamental challenge to economic policy-makers. While there are some signs of a slow reduction in youth unemployment, long-term unemployment has reached alarming proportions in some European countries, giving rise to concern that the “natural rate” of unemployment may be rising.

The main counterpart to the OECD's terms-of-trade gain has been a loss to the *developing countries* equivalent to as much as 3 per cent of their combined GNP. Faced with this development, as well as reduced access to financing from private sources, many developing countries cut back their imports sharply over the past year – at a time when some of them had not fully digested earlier

import reductions. The OECD projects that import compression will continue in many of these countries, albeit at a slower pace, over the year to come, even if their terms of trade do not change significantly, because a pick-up of capital flows to most of these countries appears unlikely.

A fundamental determinant of macro-economic performance over the medium term will be the capacity of economies to adjust in an environment marked by pronounced shifts in incomes and relative prices. Insofar as these new patterns reflect changing fundamental economic forces, or the need to correct unsustainable imbalances, it is important that the process of adjustment should be allowed to work effectively. More generally, structural flexibility will condition the potential non-inflationary growth of OECD economies and the effects of growth on job creation. While some progress has been made in recent years in enhancing the structural flexibility of OECD economies, much remains to be done.

#### Implications for policy

The main task for policy remains that of promoting the unwinding of international imbalances while maintaining low inflation and strengthening the momentum of output and employment growth for the OECD (and world) economy. A broad consensus has emerged internationally in respect of desiderata for policy consistent with this overall task.

All countries need to take appropriate steps to foster structural flexibility. While appropriate actions will differ from country to country, the following seem to be rich potential sources of better economic performance:

- More can be done to increase labour market flexibility in terms of relative wages, labour mobility and improving the adaptability of the work force to new job opportunities. Such efforts should be flanked by a range of measures to improve the functioning of other markets. In particular, policies to encourage competition, including deregulation and freer international trade, can contribute to faster job creation;
- Policies aimed at facilitating industrial adjustment should not favour particular sectors and should be neutral also in respect of the relative costs of labour and capital. Reduction of industrial subsidies, matched by tax cuts, should be given immediate attention;
- More intensive efforts are needed to reduce off-budget financing of support measures, and to bring about their full reintegration into the parliamentary budget process;

#### 4. UNEMPLOYMENT IN THE OECD AREA

##### National Definitions

	1985 Unem- ploy- ment (thou- sands)	1984	1985	1986	1987	1986		1987		1988 I
						I	II	I	II	
<i>Unemployment rates (%)</i>										
United States	8 310	7.5	7.2	7	6¾	7.1	7	6¾	6¾	6½
Japan	1 560	2.7	2.6	2¾	3¼	2.7	3	3	3¼	3¼
Germany	2 304	8.2	8.3	7¾	7½	8.1	7¾	7½	7½	7½
France	2 440	10.0	10.2	10½	11¼	10.3	10¾	11	11¼	11½
United Kingdom	3 271	11.6	11.8	11¾	11½	11.9	11¾	11¾	11½	11¼
Italy	2 471	10.3	10.6	11¼	11½	11.3	11¼	11½	11¾	11¾
Canada	1 328	11.3	10.5	9¾	9¼	9.6	9½	9½	9¼	9
Total of 7 above countries	21 684	7.6	7.5	7½	7½	7.5	7½	7½	7¼	7¼
Other OECD countries	9 013	11.3	11.4	11¼	11½	11.1	11½	11½	11½	11¾
<b>Total OECD</b>	<b>30 696</b>	<b>8.4</b>	<b>8.3</b>	<b>8¼</b>	<b>8¼</b>	<b>8.2</b>	<b>8¼</b>	<b>8¼</b>	<b>8¼</b>	<b>8¼</b>
<i>Four major European countries</i>										
OECD Europe	10 486	10.0	10.2	10¼	10½	10.4	10¼	10¼	10½	10½
EEC	18 848	10.7	10.9	11	11	10.9	11	11	11	11
Total OECD less the United States	15 975	11.3	11.5	11½	11½	11.5	11½	11½	11½	11½
22 387	8.8	8.8	8¾	9	8.8	9	9	9	9	9
<i>Unemployment levels (millions)</i>										
North America		9.9	9.6	9½	9¼	9.6	9½	9¼	9¼	9
OECD Europe		18.4	18.8	19	19¼	18.9	19¼	19¼	19½	19½
<b>Total OECD</b>		<b>30.6</b>	<b>30.7</b>	<b>31</b>	<b>31¼</b>	<b>30.8</b>	<b>31¼</b>	<b>31¼</b>	<b>31¼</b>	<b>31½</b>

##### Other OECD Countries

	1984	1985	1986	1987
Austria	3.8	3.6	4	4¼
Belgium	12.9	12.1	11¼	11¼
Denmark	10.0	8.9	7¾	8½
Finland	6.2	6.3	7	7¼
Greece	8.0	8.4	9¼	10
Iceland	1.3	1.1	1	1
Ireland	15.5	17.3	18	18
Luxembourg	1.7	1.6	1¼	1¼
Netherlands	15.4	14.3	13½	13
Norway	3.0	2.5	2	2¼
Portugal	10.5	10.2	10	10
Spain	20.6	21.9	21½	21¼
Sweden	3.0	2.8	2½	2¾
Switzerland	1.1	1.0	1	1
Turkey	12.1	12.7	13	13½
Total of above European countries	11.7	11.9	11¾	12
Australia	8.8	8.1	8	8½
New Zealand	3.6	3.9	5¼	5¾
Total of above 17 countries	11.3	11.4	11¼	11½

• On the trade policy front, all countries need to adhere strictly to the commitments made on "standstill" and "roll-back" in the GATT Ministerial Declaration at Punta del Este, and to give clear and consistent signals of their intention to move progressively towards more liberal trade régimes;

• Lasting solutions to the problem of imbalances in agriculture will require a considerably greater role for the price mechanism. To the extent it is thought appropriate to support farmers' incomes, means other than price support should be employed.

Turning to policy requirements more broadly, priorities differ from one part of the OECD area to another:

• The greatest contribution the *United States* can make is a large and sustained reduction of its budget deficit. This remains the firm intention of the U.S. authorities, and a significant cut in the deficit is likely in the present fiscal year. However, given the importance of internal adjustment in the United States, both to underpin sustained U.S. growth and to contribute to external adjustment, it is essential that further substantial reductions be achieved in 1988 and beyond;

• For *Japan* the need is to maintain a growth rate of domestic demand in excess of the growth rate of productive potential. The Japanese authorities have introduced a series of packages to this end, but as the yen appreciation and its deflationary impact have been larger than had been expected, further measures, including ones which would

encourage a fuller passing-on of terms-of-trade gains to consumers, may be required;

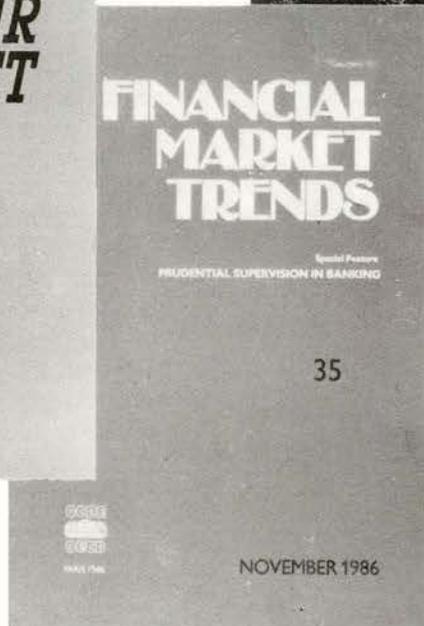
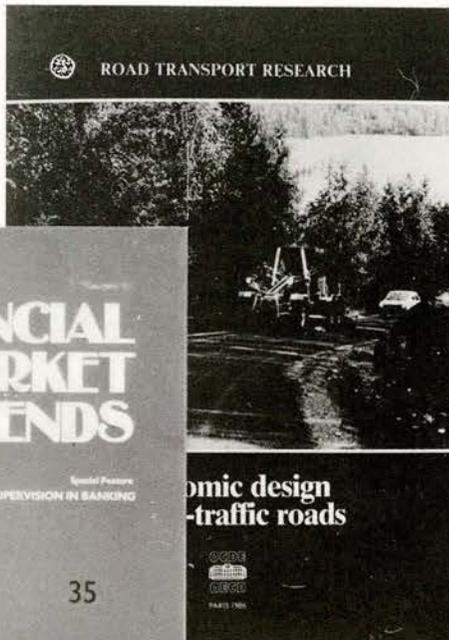
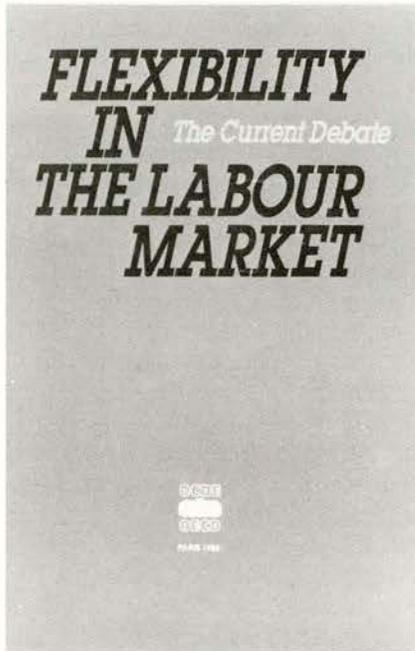
• In *Europe*, domestic demand, buoyed by terms-of-trade gains, has been growing at broadly the rates envisaged earlier in 1986. Should domestic demand weaken over the next year, the few countries that have regained some room for manoeuvre in their budgetary policies should be prepared to use it; most countries, however, still need to continue with budgetary consolidation. For European countries generally, it remains true that the better economic climate now prevailing provides the right conditions to step up efforts to reduce structural rigidities.

These policy orientations largely reflect domestic requirements. There are also important issues which derive from the international dimension. Over the past year or two, there has been heightened recognition that it is desirable for policies in different countries to be internationally compatible. This proposition would be highly pertinent in the context, for example, of a collective wish either to speed up the international adjustment process, or to attempt to stabilize exchange rates for a time. No country would be prepared to put at risk the hard-won credibility of medium-term commitments to low and stable inflation and to restoring a sustainable budget position. Nor would any country wish to aim at a rate of growth below that of productive potential if inflation was under control. Within the margins afforded by the steady pursuit of countries' medium-term objectives, however, it may be that the optimum set of policy settings in present and prospective circumstances may differ from those which would be chosen on purely short-term national considerations. The discussion above on unwinding the international imbalances makes some suggestions in this regard.

On any plausible assumptions, the reduction of the largest imbalances to sustainable levels seems likely to take a number of years, and therefore to require the financing of further substantial cumulative imbalances. It will be important to convince exchange markets not only that imbalances are starting to shrink in the short term but also that this process will be sustained by the medium-term setting of policy. From this point of view, it is particularly desirable for the largest countries to reach agreement on the key requirements of the situation, and for policy actions to be consistent with this assessment.

5 th December 1986.

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