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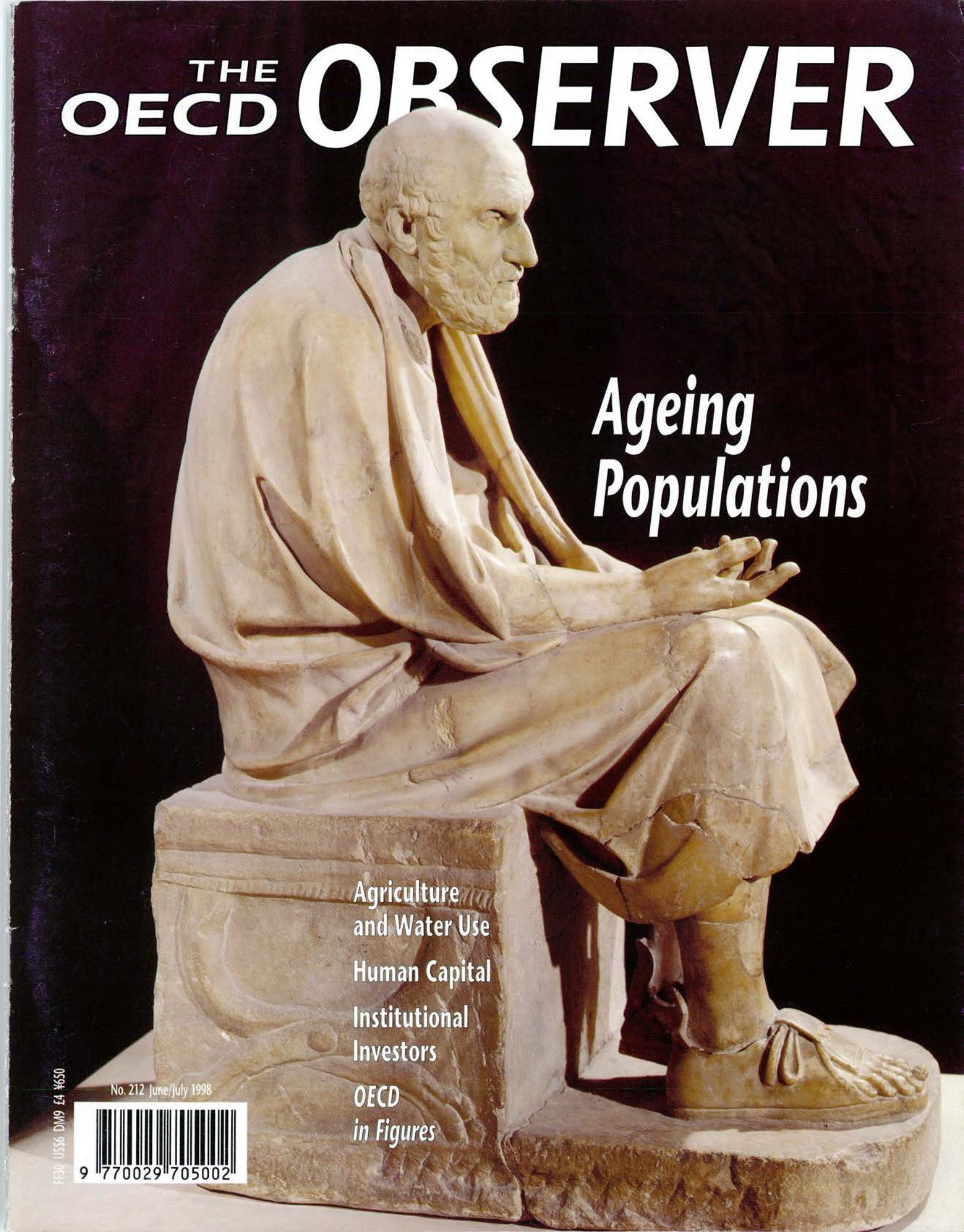

Ageing Populations

Agriculture and Water Use

Human Capital

Institutional Investors

OECD in Figures

No. 212 June/July 1998

FF30 US$6 DM9 £4 ¥650

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Open Markets Matter: The Benefits of Trade and Investment Liberalisation

The benefits of open markets are tangible. In the last decade, countries that have been more open to trade and investment have achieved double the average annual growth of more closed economies. More individuals, firms and nations than ever before depend on the gains from trade and investment liberalisation. Yet anxiety about the effects of further market integration remains.

It is essential for long-term world prosperity that countries' commitment to trade and investment liberalisation be sustained. To be credible, that commitment must be rooted in and enjoy broad public support and understanding. This makes it all the more important to communicate what trade and investment liberalisation can and cannot do and what it can be held responsible for.

Trade and investment liberalisation is not painless. It should not be viewed as a cure-all nor presented as an end in itself. It is, however, an essential component of any coherent set of policies aimed at helping societies adjust to – and take advantage of – technology-driven transformations whose pace and depth are unprecedented.

The stakes are high. This book examines the various channels through which open markets deliver considerable benefits to societies and their citizens; recalls the real costs of protectionism; and addresses the full range of concerns that feature prominently in ongoing discussions over the effects of market liberalisation on employment, income distribution, environmental protection and national sovereignty.

A central message is that liberalisation forms part of the solution to the concerns of citizens, rather than being their root cause. The book's comprehensive treatment of the ins and outs of trade and investment liberalisation should make an important contribution to the public debate.

See **The OECD Observer** No. 211, April-May 1998.

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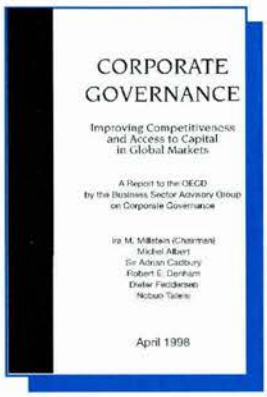
Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets

Through its impact on corporate competitiveness and access to global capital markets, corporate governance plays an increasingly important role for entrepreneurship, economic growth and employment. In its report to the OECD, the Business Sector Advisory Group on Corporate Governance emphasises that while corporate governance should remain primarily a private sector prerogative, governments have a distinct and important responsibility in providing a regulatory framework that allows investors and enterprises to adapt corporate governance practices to rapidly changing circumstances: experimentation and variety should be expected and encouraged within the limits of credible regulations emphasising fairness, transparency, accountability and responsibility.



March 1998
(92 98 04 1) ISBN 92-64-16056-6, 108pp.
FF130 US$22 DM39 £13 ¥2,700

Harmful Tax Competition
An Emerging Global Issue

Globalisation has had positive effects on the development of tax systems and has encouraged countries to engage in base-broadening and rate-reducing reforms. But it has also created an environment in which tax havens thrive and in which governments may be induced to adopt harmful preferential tax regimes to attract mobile activities. Tax competition in the form of harmful tax practices can distort trade and investment patterns, erode national tax bases and shift part of the tax burden onto less mobile tax bases, such as labour and consumption, thus adversely affecting employment and undermining the fairness of tax structures.

This Report emphasises that governments must intensify their co-operative actions to curb harmful tax practices. To achieve this, OECD member governments have developed 'Guidelines on Harmful Preferential Tax Regimes' which will discourage the spread of such regimes and encourage countries to eliminate them. To counteract both tax havens and harmful preferential tax regimes, member governments have also agreed to enter into a dialogue with non-member countries.

Forthcoming
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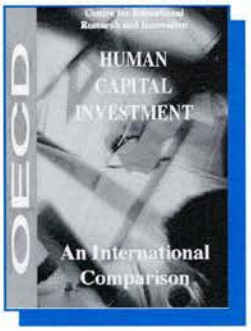
Human Capital Investment
An International Comparison

See this issue of **The OECD Observer**.



Forthcoming
(96 98 02 1) ISBN 92-64-16067-1, 135pp.
FF150 US$25 DM45 £15 ¥3,200

Maintaining Prosperity in an Ageing Society

Is ageing a threat to our societies' prosperity? How should resources be shared between the working generation and its dependent older citizens? How should pension, health and long-term care best be reformed? How can older people's contribution to society and economic prosperity be enhanced?

Within the next decade, the numbers of retired people in OECD countries will start to grow much faster than those of working age. In the absence of major changes to pension systems and to the way people allocate their time between education, work and leisure, it is likely that fiscal and social strains will start to emerge. Some groups may be unfairly burdened through high taxation and others would face unexpected reductions in their material living standards.

The appropriate policy response is multi-faceted, covering fiscal, social, labour market, financial market, health and education policies. An important part of the strategy for maintaining prosperity in an ageing society will involve encouraging people to work longer by making it financially more attractive for them to do so. In turn, this could entail reforms to traditional public pension systems and other social policies, as well as fostering the development of alternatives to public systems that give individuals more flexibility in deciding when to retire. Consequently, financial market infrastructures will need to be strengthened to cope with large increases in private pension fund assets. Through this multi-disciplinary study, the OECD points to the necessity of taking action now by implementing a comprehensive and consistent set of policies.

See this issue of **The OECD Observer**.

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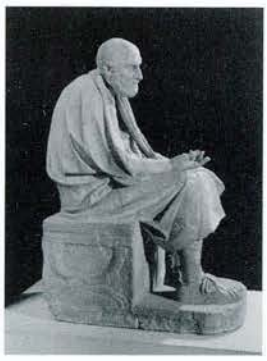

The ageing of OECD societies has implications that go far beyond considerations of public finance; it also raises questions of standards of living, quality of life and social cohesion.
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Contents

June/July 1998

Responding to Global Change

Donald J. Johnston, Secretary-General of the OECD

The OECD Economic, Trade and Foreign Affairs Ministers met in Paris last month at a point of critical conjuncture for the world's economy.[1]

Mr. Camdessus, Managing Director of the IMF, and Mr. Ruggiero, Director-General of the WTO, joined Ministers for two important debates. The first assessed developments in the world economy, in particular in Asia, and evaluated the recent Japanese economic stimulus package; the second focused on a comprehensive examination of the benefits of trade and investment liberalisation and how to chart the way forward so that countries and their citizens harness the major opportunities for improved global well-being which globalisation offers.

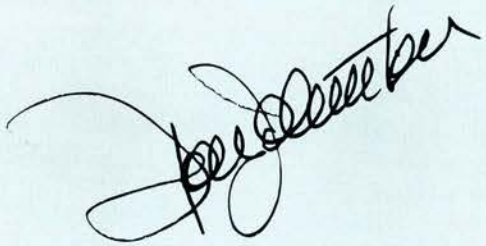
Ministers welcomed the timely measures being taken by the Japanese authorities to rekindle growth in this key OECD economy. They expressed support for Korean efforts to rigorously pursue reforms to return their economy to a high and sustainable growth pattern. Whilst the Asian crisis has been contained, its effects will be felt in the region and across the world for some time to come. Continued vigilance and improved surveillance of the world's economy are indispensable in maintaining living standards and sound economic systems.

Ministers welcomed the convergence of the economies in Europe and discussed the important contribution that the launch of the single currency will make to a more stable world economic system. All of these events demonstrate how critical effective international co-operation is in ensuring stability in today's ever interdependent world.

Making globalisation work for all countries and for all segments of society is utmost on the list of priorities of all international organisations. The new OECD study, 'Open Markets Matter: The Benefits of Trade and Investment Liberalisation', provides the analytical basis for Ministers to assist them in educating our societies about the benefits and the costs of open global markets. Political leaders in all democratic societies have an obligation to encourage informed debate on these questions which will influence our lives in so many ways.

The OECD has a crucial contribution to make in establishing clear, equitable and transparent rules of the game to provide the architecture in which globalisation will be able to be a force in fighting poverty, creating jobs and tackling the injustices of poverty in so many of the countries in the developing world. Our work on bribery and corruption, on harmful tax competition, on the Multilateral Agreement on Investment are all examples of areas where OECD governments are seeking to build agreements to ensure fairness and transparency in the international system.

The challenges that lie ahead are critical in building the basis on which economic prosperity can be constructed hand in hand with greater equity across the globe.



1. See pp. 48–53.

New Policies for Dealing with Ageing

Kumiharu Shigehara

In most OECD countries, population ageing will cause economic, social and political strains. A vital element in dealing with these strains is improved economic and financial-market performance. And policies should increasingly be seen from the 'life-course' perspective – taking people's entire lives into account. The policy response to ageing thus involves cutting across traditional boundaries of economic, financial and social disciplines, and across the customary areas of responsibility of government administrations. The OECD is uniquely placed among international institutions to deal with such cross-cutting issues.

During the years 2010–30, the baby-boom generation now in their working-age years will reach retirement age. This development, together with increased longevity and declining birth rates, will reduce the ratio of the number of people of working age (15–64) to the number of old people (over 65). In addition to these demographic factors, recent trends towards shorter periods in work through longer school and earlier retirement, if continued, would further reduce the overall supply of labour, even though the labour-market participation ratio of women may continue to rise.

In this setting, a number of concerns have been expressed:

• how will the young be able to support the public-pension benefits and health-care costs of growing numbers of older, retired people while sustaining an upwards trend in their own material living standards?

• how can the contribution of older people to the economy and society be enhanced?

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• how should infrastructures for financial markets and funded pension systems be improved to support the income of older people after retirement?

Higher economic growth will ease the constraints faced by society in general – and particularly the problems to be caused by ageing. If overall incomes are rising fast, taxes levied on the young to support the retired will be easier to bear, and will therefore be politically more practical. With economic growth, the material living standards (that is, real consumption of goods and services) of the retired can be protected while the young can look forward to rising prosperity. But if the sort of low productivity growth that has been experienced in the past 25 years continues, and if the trends towards increased unemployment and social marginalisation continue, the outcome may be very different.

How can higher economic growth be achieved? There is some hope that the information revolution, increased world trade and capital mobility, and the introduction of reforms of product and labour markets will all help to boost economic growth in the years ahead. Good macro-economic policy is a prerequisite, and cutting government budget deficits and maintaining low inflation are therefore high on the policy agenda. The OECD Jobs Study developed policies to improve labour-market performance. In addition, the OECD has undertaken work on the creation and diffusion of new technologies and on the role of entrepreneurship. All of these should help to achieve higher growth, or shape the policies that will foster it. Yet, even as such reforms are being carried out, societies must remain concerned about protecting the employment opportunities and income of the most vulnerable among the young as well as the old who may not directly benefit from such reforms.

Analysis by the OECD last year[1] already addressed many of the policy issues associated with population ageing:

• although higher labour productivity is central to increasing the living standards of the whole population, it does not directly address the fiscal dimensions of ageing; higher productivity also results in higher future pension costs since under current schemes pensions are generally related to wages. Existing public pension programmes

1. ***Ageing in OECD Countries: A Critical Policy Challenge***, *OECD Publications, Paris, 1997.*

New Policies for Dealing with Ageing

must be reformed if they are to be made sustainable

• policies will have to be developed to ensure the continued integration of the old into society, including an increased emphasis on measures early in life that allow people to respond better to changing circumstances

• the presence of increasingly older workers will require improved learning and training opportunities throughout life.

One particularly clear policy conclusion emerged from the OECD analysis: it is imperative that steps be taken soon to reverse the trend towards earlier retirement. In particular, policies that encourage or subsidise early retirement should be reformed.[2] It is clear that older workers can be productive members of the economy, and making pension arrangements more flexible for those who wish to continue work would ease the financing problem of pension programmes. Early retirement has political appeal at times of high unemployment, but such policies will only create expectations for today's workers that cannot be fulfilled.

New Policy Proposals

The OECD has undertaken further study of the reform of social security, including the option of increased reliance on private pensions. An important aspect of pension reform is the implications for intergenerational equity: current programmes imply a transfer of income from the current young to the current old. And even with funded systems, material goods and services have to be transferred in this way. There is much merit in this approach in addressing the anti-poverty objectives of pensions. It is more problematic in earnings-related pensions where, in some countries, high benefits and other design features encourage early retirement and living standards among the retired are reaching those of the population as a whole and are exceeding those of young families with children. It would make more sense to use collective resources for areas that have higher priority and to allow individuals more choice on when to retire and on the kind of income they want in retirement. More reliance on private pensions and savings can be a step in this direction.

The consequences of ageing on capital-markets have also been explored.[3] Ageing will change saving and investment patterns nationally, not least through the build-up and subsequent unwinding of private pension assets. Differences in ageing patterns across countries – particularly between the OECD and the non-OECD regions – will give rise to shifts in patterns of saving, investment and international capital flows. All these movements will be mediated through national and international capital markets, and their improved functioning will contribute to higher output growth and higher returns on pension funds by efficient allocation of savings.

So that capital markets can fulfil this enlarged role, the legal and regulatory infrastructure for securities markets will have to be strengthened. Rules governing insider trading and take-overs should enhance the capability of the capital markets to provide discipline over corporate entities. Measures should be introduced to protect the rights of minority investors, including those that enable investors to exercise corporate governance. Accounting and disclosure rules should promote transparency and accountability. The regulatory and supervisory framework for pension schemes should be modernised, with the use of the latest techniques of risk-management encouraged. At the very least, measures inhibiting the development of innovative financial instruments should be reviewed carefully – although governments may also wish to consider giving some support to the development of instruments that are useful in providing retirement income (index-linked instruments, for example).

In addition to putting a premium on raising productivity growth, policy development should address the lifelong requirements of the voters and taxpayers in the OECD countries. These initiatives involve measures to encourage the employment of older workers; reforms to the provision of long-term health care and of retirement income; reforms to education and changes to the provision of social services.

■ ■

The OECD analysis of the determinants of health, learning, productivity and the economic and social well-being of the old has been developed in the context of the 'life-course' perspective of decisions on education, work and retirement. For example, young people's educational experiences are a central determinant in work decisions, productivity and well-being later in life. It also emphasises the importance of co-ordinating policies across traditional departmental responsibilities in government. Finally, it makes clear that the time-frame for policy analysis and decision-making must be considerably lengthened.

The agenda that emerges – policies that can deliver higher growth, increase the emphasis on individuals' life-courses and enhance the role of capital markets allocating long-term savings efficiently, as well as reforms to pension and other transfer programmes – may seem a tall order. But if action is taken now first to develop and then put in place the right package of policies, the social and economic stresses that will inevitably accompany such an historic demographic shift can be mitigated. The OECD will continue to assist its member governments in designing and implementing the requisite action in both economic and social disciplines, with due regard to political dimensions, in both OECD and non-OECD countries. ■

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2. See pp. 15–19.
3. See pp. 23–27.

The Policy Challenge of Ageing Populations

Peter Hicks

People in OECD countries are increasingly prosperous and better educated; they lead longer and healthier lives and have more leisure, especially in retirement. Demographic trends – the baby-boom generation is of working age and contributing to the economy – have helped generate sufficient additional output to fund social-protection systems, and will continue to do so, but only for about another decade. Then the demographic developments, with trends towards early retirement, will put serious financial pressures on these systems. Many of the adverse consequences can be avoided if action is taken now to adapt policies to the demands of an ageing society.[1]

Ageing presents OECD countries with enormous fiscal challenges, especially in financing public pensions – the main issue driving the pace of reform. Major revisions of pensions, and of social programmes directed to people in the years before retirement such as disability benefits, will have to be in place when the baby-boom generation reaches retirement age in the period from about 2010 to 2030. Such reforms, especially to pensions, can be implemented only gradually and with advance notice, and thus have to be introduced now, if deeper pain is to be avoided at a later date.[2]

But even if there were no problems of public finance, a fundamental overhaul of policies would still be necessary in order to remove the many incentives that now encourage people to retire early and abruptly. Without it, indeed, potential gains in living standards and the quality of life are likely to be substantially curtailed and resources seriously misallocated across generations.

Material living standards depend on the proportion of individuals who are employed and on their productivity. Profound changes can already be seen in the amount of time spent in employment (Figures 1 and 2). The result will be downward pressure on living standards which will be felt from about 2010 onwards, when the percentage of the population in employment is projected to fall. If productivity continues at its post-1973 average growth rate of 1.5% annually, this decline in employment means that the growth in material living standards will be cut in half in the decades after 2010. The fiscal consequences result from relatively fewer tax-payers to pay the costs of increased pensions and health care (Figure 3). Without changes in programme benefits, there will have to be large tax increases or a new spiral of rising deficits and debt.

Reduced growth in material living standards caused by continuing to fund existing pension arrangements would not be a problem if it resulted in an increased overall quality of life. Ever-longer periods of leisure time in retirement might appear to be a worthy, if costly, social goal to be financed by taxes or payroll contributions. But spending money to this end would be at the expense of higher priorities, such as investment to improve the opportunities of poor children or unemployed youth, lifelong learning or better health.


Freddy Cats

The baby-boom

Of course, many people now choose to retire early – but their decisions are deeply influenced by financial disincentives to continue working that are built into pension and other

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1. ***Maintaining Prosperity in an Ageing Society***, *OECD Publications, Paris, forthcoming 1998.*
2. *See pp. 10–14.*

social programming and by the lack of flexible working arrangements. If these disincentives were reduced or eliminated, a sizable proportion of these would-be retirees would work longer, opting for a more gradual transition into retirement. The current lack of job opportunities for older workers also plays a major role. The evidence on what the demand for older workers might be in the future is not clear; at least some part of the problem may lie in the lower education and skills of the current generation of older workers rather than being a function of age itself – and many of the newer jobs in the knowledge-based economy are well suited to an older workforce.

Policy measures intended to foster improvements in the quality of life should ensure that pensions and other social programmes provide adequate support for people who choose retirement without imposing disincentives on those who prefer to remain in work. People should be free to choose when and how they retire: there should be no artificial incentives built into the system.[3]

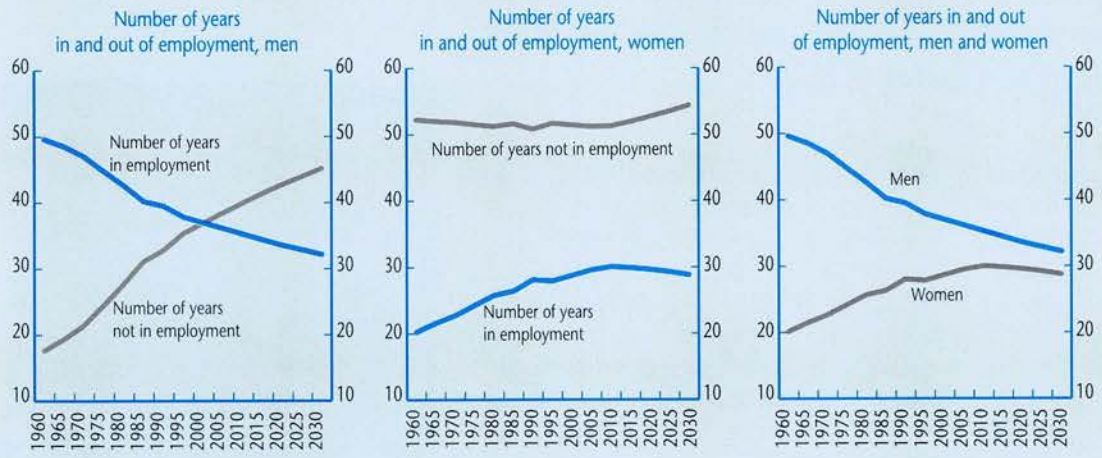
More generally, social and employment policies – and the operations of institutions providing health care and education – do not yet fully reflect the new realities of smaller families, longer and healthier lives, and much longer periods of schooling and retirement. On balance, existing policies inadvertently create incentives that result in inflexible arrangements for care-giving, learning and leisure over the course of life. The result is that social programmes and working-life arrangements now provide disincentives to choosing gradual retirement, lifelong learning or working-time flexibility.

A Growing Misallocation of Resources

The failure to keep up with demographic realities can cause a misallocation of resources between older and younger people. Although there are still many problems in assuring adequate income in retirement, particularly for the very old, most retired people are now much better-off than they would have been in an earlier age, so that their average income is now close to that of the population as a whole. Retired people, indeed, already have disposable incomes that, on average, are as large as those of people in young households.

There is no necessary link between the generosity of public pensions on average and the extent to which retirement income is adequate and equitably distributed.[4] Further, a continuation of existing arrangements will result in more money being transferred to older people than they now spend. Many retirees are now providing financial support to their children and grandchildren, sometimes in substantial amounts. Indeed, even the poorest among older people often continue to save. The result is certainly inefficient since public benefits are being transferred to those who do not use them but rather pass part of those benefits on to others. It is probably inequitable as well – perpetuating the gap between rich and poor families,

Figure 1
Employment in OECD Countries, 1960–2030



In a typical OECD country in 1960:
- *men lived some 68 years, of which 50 were spent in work*
- *the other 18 years were mainly spent in infancy and school, and a short period of retirement*
- *women worked in paid employment for around 20 years on average.*

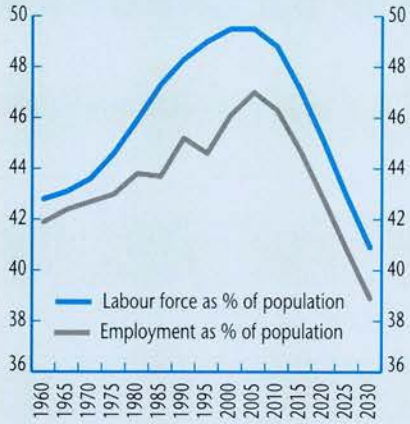
The changes since then have been deep and steady.
Today:
- *men will live to 76 with only half their lives – 38 years – spent in employment*
- *the other 38 years are spent in much longer periods of time in education, unemployment and, especially, retirement*
- *trends for women are also sharp, although not as sharp as for men; women are spending more of life in employment and will continue to do so, until about 2010 when their participation reaches 90% of men's.*

If existing trends were to continue, by 2030 men would spend substantially more of their lives outside work, and employment patterns for men and women would have become similar.

Note: Projections from 1995.
Source: OECD

3. See pp. 15–19.
4. See pp. 20–22.

Figure 2
Shares of the Labour Force and Employment in Total Population, 1960–2030



The baby-boom generation is now of working-age, increasing the number of paid workers relative to non-workers (and helping offset the decline in the employment-population ratios for men).
During the period 2010–30, when the baby-boom generation reaches retirement age, three phenomena – increasing life-expectancy, labour-force trends and population ageing – will begin to work together in reducing the amount of time that a society devotes to employment.

Note: Projections from 1995.
Source: OECD

especially since pensions are given tax advantages in many countries.

There is therefore a strong reason on grounds of social priorities to reform pensions and undertake related changes to labour-market and social policies in ways that will reduce, or offset, trends to increasing time spent in receipt of public pensions, and to reduce the relative generosity of benefits in countries where they are now particularly high.

Corrective action to pensions must begin early – a basic 'contract' such as that embedded in public pension arrangements cannot, and should not, be changed quickly or without the prior notice that will allow people to adjust their plans.

There is also a question of trust. Many young people do not believe that decent public pensions will still be available when they retire. And fears have been expressed that the very large increases in taxes which would be necessary to maintain existing arrangements might reinforce resistance to paying taxes and, possibly, to inter-generational conflict, even if there is currently little evidence of it. Since the main effects of ageing will only be felt after 2010, this lack of conflict may be the calm before the storm. But it may also reflect large inter-generational transfers to young people in families. As noted above, many young people are themselves dependent (directly or indirectly) on the income their parents or grandparents receive, and do not recognise that the difficulties they encounter in finding employment or in earning adequate take-home pay may be related to the payroll-based taxes which finance the pensions and other social transfers received by their parents and grandparents.

What Directions for Reform?

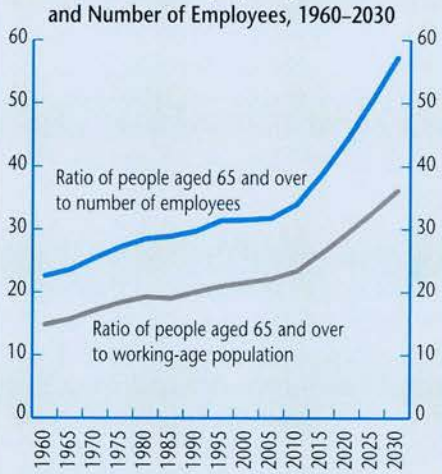
Tackling the fiscal challenge, the threat to living standards and quality of life and the potential for generational imbalances simultaneously is a daunting endeavour. It requires a package of reforms that, taken as a whole, will result in:

- reduced growth in government spending on pensions and a slowing or reversal of trends towards longer periods of retirement
- more productive investment of private savings for retirement
- wider choice for individuals about the course of life, not least by removing both artificial incentives that now favour sudden and early retirement and disincentives to choice built into existing programming
- a general re-orientation of health, training, care and other policies so they better support people, as they grow older, in leading productive lives.

Taken one at a time, these reforms are desirable on both social and economic grounds, quite apart from considerations imposed by population ageing. By and large, they are prudent policies that should be pursued more forcefully and over a prolonged period. Taken together, they represent nonetheless a considerable shift in both the substance and process of policy-making.

Approaches to pension reform illustrate the new directions policy should take. In recent years, pension reform has largely been driven by fiscal concerns alone – which will become increasingly insistent in the period after 2010 unless actions are taken now. But new social-policy considerations are beginning to influence the pension reforms being considered as the debate shifts to examine the nature of retirement itself, not only its financing. The traditional concentration on choice between competing sources of pensions – often between public pay-as-you-

Figure 3
Ratio of Persons Aged 65 and over to the Working Age Population and Number of Employees, 1960–2030



In 1960, the older population was about 15% of the working-age population. Currently it is about 20%. By 2030 it could jump to 35%, with most of growth after the year 2010. In 1960, for every older person there were nearly seven people of working age. The figure is now about five, and by 2030 it will be less than three.
The upper curve is used to examine the fiscal burden of ageing. The rate of growth in this ratio gives a rough indication of the increased pension burden per employee if pensions were entirely funded through the wage bill. In 1960, the number of older people was about 22% of the number of employees; that is, for every older person there were over four employees to provide support. Currently, there are about three, and that will continue for another decade. After 2010, the trend changes sharply. By 2030, the size of the older population will grow to 50%, that is, there will be only two employees for every older person.

Note: Projections from 1995.
Source: OECD

go schemes and advance-funded individual-account schemes – is being dropped in favour of an analysis of the best balance among multiple pillars or tiers, often involving new mixes of pension elements and non-pension sources of retirement income. Attention is likewise shifting from an almost exclusive focus on the relative generosity of pension benefits to include their duration.

More generally, there is a new focus on the role of generational issues and on the interaction between changes in families and markets. The concept of 'active ageing' plays a central role in this new focus: active-ageing policies are those that are designed to support people, as they grow older, in leading productive lives in the economy and society. Especially important is flexibility in the choice of whether or not to retire and how gradually. And the links between social and economic policies take on new importance, as is reflected by the new priority on lifelong learning and the effectiveness of health and long-term care.

■ ■

These reforms also represent a considerable new challenge to the manner in which governments formulate policy. Part of the challenge involves adopting and sustaining perspectives that are much longer-term than is usual. Furthermore, the reforms are unlikely to be successful if they are tackled in isolation; and new kinds of statistical information and applied research are required to support them. The long time-frames involved, and the complexity of the issues likewise require the building of public understanding and engagement and the establishment of viable political support. ■

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The Economic

Nicholas Vanston

Secular declines in birth rates and rises in life expectancy have meant that the average ages of the populations of what are now the OECD countries have been rising for at least a century and a half. But the rapidity of the demographic developments now affecting the OECD economies is unprecedented, which raises very large questions for policy-makers.

Although life expectancies have been rising more or less steadily for a long time, the secular fall in birth rates was sharply reversed after the end of the Second World War – the so-called 'baby-boom'. For a brief while, OECD societies got younger again. But then birth rates fell back, and kept on falling. The baby-boomers have had relatively few children of their own and, unless fertility rates recover, or immigration increases, the populations of many OECD countries will be lower in a few decades than they are now. This continued fall in birth rates was unexpected, and demographic projections over the past 20–30 years have had to be successively revised downwards.

As a result, most OECD countries have a large bulge of 'baby-boomers' now in their prime earning years – the oldest of them are in their early fifties – but comparatively few young adults or children. Concurrently, the proportion of older retired people rises all the time because of population growth in the past and increasing longevity in the present. Ageing is also occurring in most non-OECD countries, because people there are living longer, but their birth rates have proved more sustained than in OECD countries. For some time, the baby-boom phenomenon has been beneficial to the OECD economies. Although bringing the baby-boomers to adulthood was an expensive exercise – because of their numbers and because they spent more time in full-time education than their predecessors – they subsequently swelled the ranks of productive workers, paying the taxes that support the young, the old, the sick and the unemployed.

Older Workers

The baby-boomers will shortly start moving into the category of 'older workers' – a vague term, usually applied to those over 55 years of age. People of this age-group tend to be relatively well paid, but have more difficulties than younger workers in finding a new job if they are made redundant, and generally change jobs less frequently than younger ones. They are also often regarded as being less productive than younger workers, so that employers are often ready to lay them off.

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Impacts of Ageing

Yet there is very little reliable empirical evidence to establish whether older workers are indeed less productive than younger ones. One fact is clear: the older workers of today are on average less well-educated than today's younger workers, simply because today's older workers are much more likely to have left full-time education in their mid-teens. So the observed tendency selectively to lay-off older workers may reflect more their relatively low educational attainment, coupled with their relatively high wages, than low productivity because of age. It certainly seems to be the case that the older workers who stay in the labour force are on average better educated than those who leave. Arguably, then, the problem of the 'low-productivity, high-wage' older worker could diminish in coming years.

Even if it does so, this problem will probably not disappear, and it would be prudent to assume that there will continue to be a large number of people over 55 who have *de facto* withdrawn from the labour force through long-term unemployment or disability.[1] In any case, whether or not older workers are inherently less productive than younger ones doing comparable jobs for comparable salaries, it is undeniable that the older ones are less flexible in the sense that they are less able – or less willing – to acquire new skills. Since the acquisition of new skills requires an investment of time and effort, this difference may represent a rational decision by older workers (or their employers) not to proceed with such an investment if they are not going to stay long enough in the workforce to recoup the cost. But by the same token, because older workers change jobs less often, it should logically be more profitable for employers to invest in training them.[2] Whatever the reason, most OECD countries are going to be faced with the problem of having an unusually high proportion of employees in the less flexible age-groups, in a world that is changing rapidly, where new techniques and new ways of doing business are becoming more and more common. The competitive edge of the OECD countries in their own and other markets could be eroded as a result.

The Pension Problem

In about ten years' time another, and potentially more serious, problem will emerge as the baby-boomers start to retire. The numbers of retirees will rise faster than in the past, and they will continue to rise quickly for many years. By contrast, the numbers of people in the economically active cohorts will start to shrink in many countries and – unless a higher proportion of them can be encouraged to take jobs, or retire later – the proportion of the population that is employed will also shrink. In some countries, indeed, the absolute numbers of employees is likely to fall. Unfortunately, in the public pension systems currently in force in the OECD countries, it is generally the taxes of people in work which pay the pensions of those who are retired – there is no 'fund' into which an employee's pension contributions are paid, and which could be drawn on when that employee retires (box, p. 12). The money goes straight to service existing pensioners. So, in a decade or so, the cost of public pensions will rise faster than ever – unless hard decisions are taken soon – and the tax base for financing them will simultaneously shrink.[3] To the extent that older people use medical resources more intensively than younger citizens (box, p. 14), population ageing will put additional pressure on public finances, since there will be relatively more older people.

The public-pension problem is thus fiscal in nature. Unless existing individual pension benefits are reduced and/or individual contribution rates are raised, the gap between revenues and expenditures will show up as a gap in public finances and would entail either rising public-sector deficits, higher taxes, lower expenditures on other items, or a combination of all three. It is a serious problem because the numbers are large: if left unchecked, public-sector deficits could rise again to the volumes of the 1980s. Government debt would soar, exceeding 100% of GDP in Europe and Japan, and up to 70% in the United States.

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Older but active

1. See pp. 15–19.

2. Bernard Casey, 'Incentives and Disincentives to Early and Late Retirement', OECD Working Paper, forthcoming 1998; available free of charge from the Resource Allocation Division of the OECD Economics Department.

3. Lans Bovenberg and Anja van der Linden, 'Pension Policies and the Aging Society', **The OECD Observer**, No. 205, April/May 1997.

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What Hope from Funded Pensions?

Funded pension systems are those in which employees and employers make contributions to a genuine fund, which earns interest, and out of which pensions can be paid on retirement. Schemes of this sort are sometimes individually tailored, sometimes not, often privately organised and run, but not necessarily so. Private pension funds invest their inflow of contributions in financial assets, the value of which can vary substantially. Funded schemes are therefore inherently risky. Nonetheless, under plausible assumptions about demography, productivity and profitability, they could well yield the same degree of pension benefits as pay-as-you-go (PAYG) systems at present, and perhaps more cheaply. PAYG is attractive when both the labour force and its productivity are growing rapidly, neither of which holds at the moment. Funded systems might also result in higher national saving if they gradually supplant part of existing public systems, and especially if co-existing PAYG systems are run in such a way as to avoid any build-up of public-sector debt. Higher saving would in turn lead to higher output later on. There is no 'free lunch', though: investing for higher output at some time in the future entails sacrificing some consumption now and for some years to come. Still, that higher output might well be valued more highly when there are more people who have to share it.

This potential fiscal problem is a symptom of the real and inevitable challenge posed by ageing, namely, how to ensure that pensioners enjoy adequate living standards without placing large burdens on the working generations. Only people in work generate incomes, but both workers and retirees (as well as society's other dependants) consume. As the number of retirees rises and that of workers shrinks, other things being equal, there is less to go round. Building-up debt is no solution: eventually it has to be repaid, and to the extent that rising debt entails rising interest rates, it will crowd out private investment and living standards for everyone will suffer. It should be emphasised that ageing will not suddenly result in massively lower living standards: the impact each year will be small, but the cumulative effect over two or three decades will be substantial. That is why some countries – Italy, the United Kingdom and the United States, for example – have begun to take steps to deal with the coming problems, and all governments recognise that these are issues that have to be addressed soon.

What Solutions?

What, then, can be done? There is no simple, painless solution to meet all cases: population ageing will put downward pressure on material living standards wherever it happens. There are nonetheless several policy actions that would reduce the pain in any case, and/or render it less acute by spreading it over a longer period and more people, by:

- raising the volume of output so that living standards can be higher for everybody once the demographic pressures begin to bite
- putting public finances in as healthy a position as possible so that some extra demands on the public purse can be tolerated for a while
- ensuring that lengthy periods in retirement in relative affluence are not financed at the expense of younger generations.

In fact, all these policy actions are desirable in themselves:[4] they simply become more important and more urgent because of the demographic background.

Raising Output

If OECD countries pursue programmes of structural reform – in labour and product markets – one can reasonably expect that, over the medium term, output would be higher and unemployment durably lower, with unambiguous gains in welfare. OECD calculations put potential gains from realistic programmes of product-market reforms (the privatisation of public utilities and enforcement of competition policies, for instance) at several percentage points of GDP,[5] and many analysts believe that longer-term gains in the form of higher potential growth-rates of output are likely. Even the immediate gains in efficiency would suffice to offset the impact of ageing for several years – and if long-term growth-rates can be raised by as little as half a percentage point for two or three decades, it would offset the impact of ageing altogether for the OECD area. Sustained application of the policy recommendations in the OECD 'Jobs Strategy' – chiefly stable macro-economic conditions, more flexibility in working time and wage rates, and better training – would also help increase output by raising employment. Evidence is piling up that those countries such as the Netherlands, Ireland, New Zealand and the United Kingdom which have made far-reaching labour-market reforms are now reaping the benefits in the form of lower structural unemployment.[6] It also seems increasingly clear that a well-sequenced set of reforms of regulation, combined with others in the labour market, feed on each other and make both of them more effective.

Just as older individuals can maintain their standard of living by running down savings, so can ageing societies. It is likely that national saving in many countries will increase for a while as governments pursue fiscal consolidation and the baby-boomers pass through their high-savings years, before falling as the retired population rises. But it is not always easy for many individuals to save for their retirement, and government may have a role in facilitating such saving – for example, through appropriate en-

4. See pp. 7–10.

5. The OECD Report on Regulatory Reform, Volume II, 'Thematic Studies', Chapter I, OECD Publications, Paris, 1997.

6. The United States, Japan and Norway also stand out as countries with good labour-market performance, largely because they have consistently followed policies that prevented structural unemployment rising significantly in the first place. See ***Implementing the OECD Jobs Strategy: Member Countries' Experience****, OECD Publications, Paris, 1997.*

couragement and regulation of private funded-pension schemes. Governments should also consider the contribution of public budgets to national saving; in most cases, although it is rarely convenient in the short term, governments will have to continue to pursue fiscal consolidation – reducing deficits or increasing surpluses.

Improving Public-sector Finance

The fiscal problem could be solved by raising pension-contribution rates in the future to whatever figures would be necessary to ensure that benefits could continue at similar amounts to today (relative to wages). This 'solution' has drawbacks: the contribution rates would have to rise so much (to over 40% of gross wages in some countries) that they would cut the disposable incomes of tomorrow's workers by substantial amounts. They might thus discourage some people from working at all and encourage business (and employees) to migrate to countries where pension contributions were less onerous. Raising contribution rates in this way would be tantamount to attempting to preserve the living standards of the old at the expense of those of the rest of society – and ultimately everyone would suffer.

Another solution would be to cut pension benefits to whatever rates are necessary to ensure that contribution rates for individual employees do not have to rise above the equivalent of what they pay today. This 'solution' would preserve the living standards of employees at the expense of those of the retired population, who would have no way of compensating for their cut in income. Furthermore, the cut in old-age income would have to be very large in many countries, putting many pensioners below the poverty line – something society will simply not accept.

But to some extent elements of both of these measures will have to be used, perhaps in combination with what is called 'pre-funding'. Pre-funding entails building up a reserve in the public-pension system, which can be run down later on when the demographic pressures


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Who will pay?

become more severe. For employees, it means that contributions will start to rise before the baby-boomers start retiring but they will do so less thereafter. Since the distorting effects of payroll taxes on work effort rise disproportionately rapidly as they increase, reducing the peak rates of payroll taxes should reduce distortions over time. Several countries have adopted pre-funding, or are intending to do so. And in fact, pursuing fiscal consolidation by reducing public-sector debt in the medium term has very similar results to 'genuine' pre-funding. With pre-funding, there is a separate and visible fund that is earmarked for pension payments. With fiscal consolidation, the anticipatory improvement in public finances permits some increase in debt when the pension pressures start to emerge.

The citizens of the OECD countries not only have longer life-expectancies than they did at the time when most public pension systems were being implemented; they also retire earlier. An increasing proportion of people's lives is spent in retirement, at each end of the retirement-age spectrum. At the same time, the average income (from public and private pensions and savings) of an 'elderly household' has risen very substantially in real terms. Although there are pockets of poverty, mostly affecting elderly people with no spouse and no 'earned' pension, old age for most people is no longer a period beset by money worries and ill-health. In most countries, nonetheless, public pensions are the largest single source of income in old age – and unless individual benefits become less generous, or time spent in retirement falls, financing such incomes in future will impose a large and rising tax burden on future workers.

Longer life-expectancy, and in good health, is a major achievement of economic advance, and one that shows every sign of being maintained, even improved. Whether the trend towards earlier retirement is beneficial is harder to judge. Those who retire early mostly do so voluntarily and gladly. And to the extent that their longer retirement is financed out of their own accumulated savings, or from public pensions which are appropriately adjusted downwards for people who retire before the standard retirement age, there is no reason for governments to interfere.

But OECD calculations suggest that the workings of the public systems, coupled with other sources of social-transfer income for older workers (long-term unemployment benefits, for example, or disability pensions) often have the


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Supporting the grandchildren

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Ageing and Health Care

Older people use more health care; the medical costs of pensioners are underwritten by public health systems in OECD countries; and there will be more and more older people. As a result, the cost to the taxpayer of financing the health costs of the aged will very probably rise in coming decades. The costs of treating children and working-age adults may well fall, because there will be fewer of them; this trend will help to offset the rising health-care costs of older people, but almost certainly not by enough.

One of the major problems in assessing by how much age-related health costs will rise is that there are not enough reliable data on the medical histories of individuals throughout their lifetimes. It may be that old people live longer, healthier lives because they now receive more, or better-quality, medical treatment than they used to. Or perhaps their health in general is so much improved by the time they enter retirement that they require less treatment than their predecessors. Such evidence as there is gives no clear indication. Depending on the assumptions made, age-related health costs could fall, relative to GDP, over the coming decades, or they could rise even more than those of financing public pensions.

Yet it does seem to be well established that there is a rapid increase in health costs in the year or two before death, irrespective of the actual age at death. It follows that ageing populations will entail no more increase in health costs than the increase in the death rate itself – provided that the costs concentrated at the end of life do not themselves rise steeply on a per-patient basis. Some newer medical technologies bring savings, whereas others improve quality of life, perhaps only briefly and at relatively high cost – heart bypass operations would fall into the first category, perhaps, and prolonged intensive care into the second. These issues, and priorities for medical research into ailments and diseases and disabilities of old age, are questions which require further reflection.

Old age can end in a prolonged period of full-time care at home or in a nursing home. In many countries, care of this sort has to be financed out of the income and assets of the person concerned, and/or their family, until these resources have been exhausted. For the person concerned and their families, such an end to life is not only distressing but also financially ruinous. Some countries are setting up, or have set up, collective insurance schemes to finance such demands.

effect of making earlier retirement financially attractive and working after the standard retirement-age very unattractive.[7] In effect, tax revenue is being used to encourage older workers to retire early. This measure both raises the number of retirees and reduces the number of productive workers who can support them. Very approximately, for each year that the average working life falls, GDP falls by 2 percentage points and pension contributions have to rise by 7 percentage points, relative to gross wages. Much of this cost is borne by the retirees themselves in wages foregone, but the state also loses tax revenue and where, in addition, early retirement is subsidised (for instance, by not reducing pension payments in line with reduced years of contributions) the financial costs to the exchequer of early retirement are substantial. It could be that, even if these incentives were removed, many people would still leave the labour force before the standard retirement-age, but at least the cost to the working population would be reduced.

Apart from the financial incentives to early retirement built into existing pension and social-security systems, there are also a number of arbitrary rules and practices that discourage later retirement. It is easy to show that the size of an eventual pension should rise quite rapidly if people continue to work after the standard retirement-age – if pensions were actuarially fair. In practice, though, this rarely happens: older employees continue to make mandatory contributions but their eventual pension is no larger. It is also often the case that to become eligible for an occupational pension an employee must leave his or her current job; and in most countries benefits paid from public pensions are sharply curtailed if the pensioner takes up gainful employment again. For these reasons, the proportion of people over 65 years who are still working has fallen precipitously, with Iceland, Japan and Korea being major exceptions.

■ ■

The demographic bulge of baby-boomers, who will start passing into retirement in ten years' time, will put enormous strains on public pension systems as well as reduce the growth of average living standards. Fortunately, the policy measures that can alleviate the burden – labour- and product-market reforms, fiscal consolidation – are those that governments should favour whether or not there is an ageing problem. ■

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7. See pp. 15–19.

Retire Early, Stay at Work?

Sveinbjörn Blöndal and Stefano Scarpetta

The combination of increasing life-expectancy and earlier retirement has profoundly altered the allocation of time between work and leisure of elderly people in all OECD countries. In the early 1960s men spent on average two-thirds of their life at work – a proportion which had fallen to less than half by the mid-1990s. The increased leisure that older individuals enjoy has costs in terms of high budgetary outlays for government and lower productive capacity for the economy as a whole. Yet, perversely, in almost all OECD countries, pensions and other benefits discourage older people from working, imposing an implicit tax on continued work that has increased markedly since the 1960s, and playing a substantial role in driving down the average retirement age.

Over the past decades most OECD countries have experienced a substantial drop in the average age at which individuals retire from the labour market (Figure 1). In 1960, the average age of retirement for males was around 66 in the OECD area as a whole, with comparatively small variation across countries. By 1995, that average had dropped by four years, with striking differences emerging between countries. Two, Iceland and Japan, did not experience marked changes over this period, since males there continued to work on average well beyond the age of 65. By contrast, several continental European countries – Austria, Belgium, Finland, France, Luxembourg and the Netherlands – experienced declines of over five years, which brought their average age of retirement to well below 60. The average age of retirement for women, though historically lower than that for men, followed a similar trend over the past three decades and currently stands well below 60 in two-thirds of the OECD countries.

If average retirement ages stabilise at their current low positions, or fall even further, the adverse output and budgetary implications of ageing populations would be amplified. By the same token, if past trends were to be reversed and people began to retire later, the ageing problem would be mitigated. So what are the driving forces behind the trend towards earlier retirement? Chief among them are the incentives to retire that are embedded in public and mandatory[1] private pension schemes as well as in other public benefit systems. Another major influence is the deterioration of labour-market conditions in general, and for older workers in particular, in many European countries.

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The Impact of Incentives

All OECD countries have government-run systems to support people in their old age, often supplemented with mandatory private schemes. There is wide variety between countries in the institutional set-up of old-age income-support schemes. National pension systems involve one or more of the following pillars:

- basic pensions of a fixed amount to all individuals

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Intergenerational conflict?

- earnings-related pensions, whereby people contribute to the system during their working life in exchange for earnings-related benefits in retirement
- contribution-based pensions, where benefits are directly linked to past contributions to pension funds and returns on their investments.

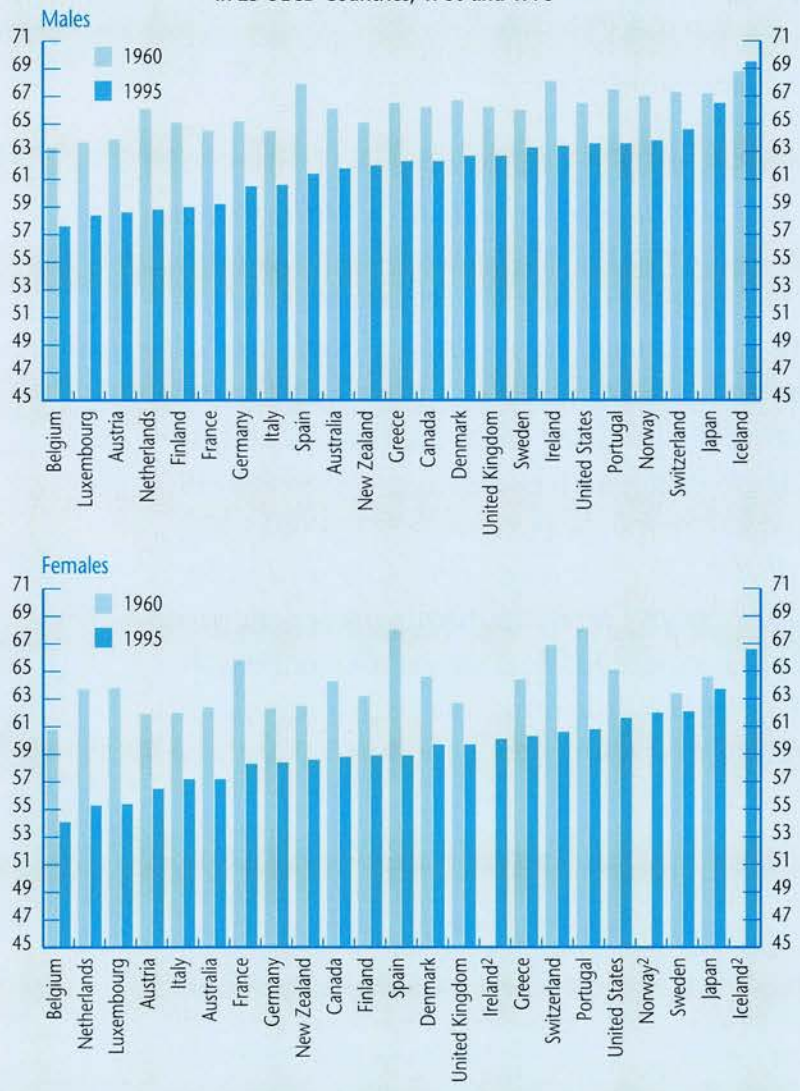
*1. That is, those private pension schemes which the state obliges the individual to join; see Willem Adema, 'Uncovering Real Social Spending', **The OECD Observer**, No. 211, April/May 1998.*

Retire Early, Stay at Work?

Contribution-based pensions, which are becoming more popular, do not influence the decision on when to retire: each year of continued work and contributions is rewarded by higher pensions. But features in the design of the other two types of pension may have a strong influence on that decision.

The age at which people become entitled to pensions differs in OECD countries (Table, p. 18). For males, the standard age is 65 in about half of them, and ranges from as low as 60 in a few countries (Belgium, France, Japan) to 67 in some Nordic countries; the entitlement age is often lower for females. More importantly, the standard entitlement age has been falling since the 1960s, with predictable effects on when people choose to retire. In Belgium, France and to a lesser extent in Ireland, New Zealand and Sweden, for example, it has led to substantial falls in participation rates among older people (55–64 years of age); the higher standard ages of retirement in Denmark, Iceland and Norway, instructively, have helped maintain high participation rates.

Figure 1
Average Age of Retirement[1] in 23 OECD Countries, 1960 and 1995



1. Estimates.
2. Data for 1960 not available.
Source: OECD

Indeed, there are few incentives for staying on in the labour force after the standard age of retirement. Continuing to work for an additional year often means simply that a year of pensions is forgone with often little or no increase in eventual pensions in exchange. Two countries – Portugal and Spain – make entitlements to old-age pensions beyond the standard age conditional on complete withdrawal from the labour market. And some countries (Finland and France, for example) will grant public pensions only if individuals stop working with their current employer, a qualification that can be a *de facto* restriction on work in view of the difficulty older workers can have in finding a new job. Moreover, in countries where there are no direct or indirect restrictions on work beyond the standard entitlement age, the means-testing of pension benefits tends to discourage work: since pensions are reduced as earnings increase beyond a certain point, work becomes unprofitable.

But since the average retirement age is considerably below the standard entitlement age in many OECD countries, these are obviously not the only incentives encouraging early retirement. In many countries, these further factors include the accessibility of pensions before the standard age (under certain conditions). Several European countries allow workers to draw pensions when they have reached a given age and contributed to their pensions for a given number of years. For example, the minimum age for pension entitlements for men ranges from 58 (Greece) to 63 (Germany) and was even earlier in Italy, until recently; and the minimum age for women is generally lower than for men. A number of OECD countries (Canada, Finland, Sweden and the United States among them) have flexible retirement arrangements but permanently reduce pensions that are called upon before the standard entitlement age.

The 'generosity' of public pensions is also important in the decision when to retire. A pension that is low relative to earnings is unlikely to encourage withdrawal from the labour force. And, indeed, the generosity of

2. See pp. 20–22.

pensions has increased markedly in most OECD countries since the 1960s. In 1961, the breadwinner on average earnings could expect to get no more than a third of his or her earned income in pensions in about half of the OECD countries for which data are available; and replacement rates[2] of more than 75% were to be expected in only three countries (Austria, Germany and Portugal). By 1995, none of the OECD countries provided their pensioners with pension benefits below one-third of their previous gross earnings, and older workers in ten countries could expect to have replacement rates above 75% – and in two, Greece and Spain, pension payments even matched or exceeded earnings in work. This increased generosity has mostly eliminated poverty among older people, and made retirement from work much easier.

The rate at which pension payments increases with the length of the contribution history also has important effects on the decision to retire: the incentives to continue working will be strengthened if additional contributions are matched by sizable increases in pensions. But the rates at which pensions accrue differ widely across OECD countries. On one end of the spectrum are countries (such as Australia and New Zealand) where pensions are not related to employment or contribution records, which means that the accrual rate is zero. At the other end are countries (Germany and the Netherlands are two) where pension payments increase over the whole of a normal working life. Between these two extremes are countries where full pensions are earned relatively quickly – which implies that the accrual rate for older workers is zero. In fact, in almost half of the countries for which data are available for 1995, a 55-year-old worker could expect no, or an insignificant, increase in his pension by working for ten additional years.

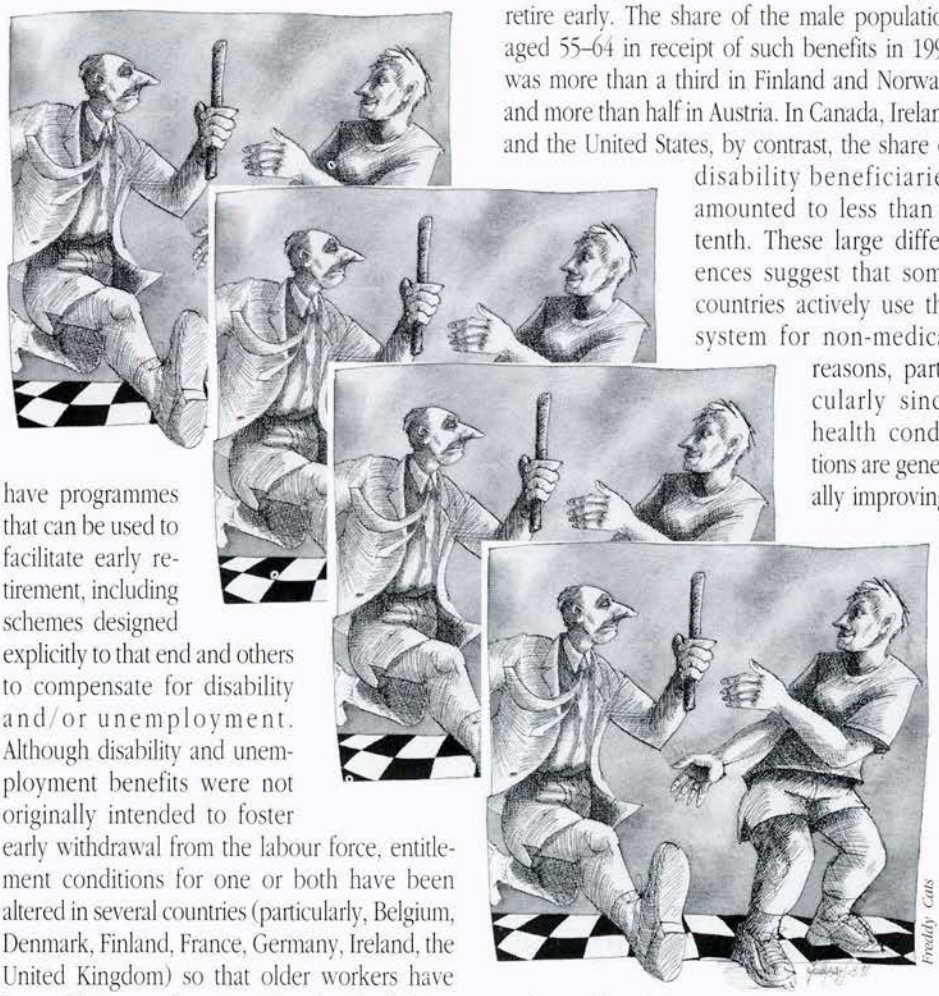
Yet as a rule accrual rates for pensions were considerably higher in the 1960s. For example, ten additional years of work for a 55-year-old increased the old-age replacement rate by up to a third in Belgium and a fourth in France. Since then accrual rates have been reduced in most OECD countries, thereby strengthening the disincentive to stay on at work. And as one might expect, empirical evidence suggests that countries (Denmark, Iceland, the United States) with pension systems that are broadly neutral on decisions on when to retire have maintained considerably higher participation rates among older workers.

Other Benefit Systems

Even where public-pension systems discourage work at older ages, few individuals would be in a position to retire before they were entitled to a pension unless they enjoyed other benefits that provide income support until they reached the pensionable age. Most countries have programmes that can be used to facilitate early retirement, including schemes designed explicitly to that end and others to compensate for disability and/or unemployment. Although disability and unemployment benefits were not originally intended to foster early withdrawal from the labour force, entitlement conditions for one or both have been altered in several countries (particularly, Belgium, Denmark, Finland, France, Germany, Ireland, the United Kingdom) so that older workers have been able to use them to retire ahead of time.

In 1995, in over half of the OECD countries, unemployment-related benefits could be drawn from age 55 to the standard pensionable age. Unemployment for a given length of time up to a prescribed age allows early access to old-age pensions in seven OECD countries, and older workers have used this retirement option on a large scale in Finland, Germany and Spain. Since the late 1970s, a number of countries have also relaxed entitlement conditions for unemployment-insurance benefits for older workers, exempting the unemployed above a given age from having to search actively for a job. There is also evidence that work-tests are applied more leniently in countries which do not formally exempt older workers from standard job-search criteria.

Disability schemes are used extensively to retire early. The share of the male population aged 55–64 in receipt of such benefits in 1990 was more than a third in Finland and Norway, and more than half in Austria. In Canada, Ireland and the United States, by contrast, the share of disability beneficiaries amounted to less than a tenth. These large differences suggest that some countries actively use the system for non-medical reasons, particularly since health conditions are generally improving.



Passing on knowledge

Retire Early, Stay at Work?

Table
Age of Entitlement to Old-age Pensions, 1995

	Standard age of entitlement		Earliest age of entitlement	
	Males	Females	Males	Females
Australia	65	60	..	..
Austria	65	60	60	55
Belgium	65	60	60	60
Canada	65	65	60	60
Czech Republic	60	57	..	53
Denmark	67	67	..	..
Finland	65	65	60	60
France	60	60	..	..
Germany	65	65	63	60
Greece	65	60	58	57
Hungary	60	56	..	..
Iceland	67	67	..	..
Ireland	66	66	..	..
Italy	62	57	52[a]	52[a]
Japan	60	58	..	..
Korea	60	60	..	..
Luxembourg	65	65	60	60
Mexico	65	65	..	..
Netherlands	65	65	..	..
Norway	67	67	..	..
New Zealand	62	62	..	..
Poland	65	60	..	..
Portugal	65	62.5	..	..
Spain	65	65	60	60
Sweden	65	65	60	60
Switzerland	65	62	..	..
Turkey	60	55	46	41
United Kingdom	65	60	..	..
United States	65	65	62	62

.. not available
a. 1996.

There are indeed strong indications that entitlement conditions have been *de facto* eased in disability-benefit systems throughout the OECD area, even in countries where disability is supposed to be assessed against rigid medical criteria only: Canada, France, Japan, New Zealand, the United Kingdom and the United States. In countries, mainly continental European, where disability is assessed against the capacity to perform in a suitable job, increased unemployment may have resulted in an easing of eligibility requirements to accommodate early retirees. The easing of entitlement conditions has been most explicit in countries with a labour-market criterion for granting disability pensions[3].

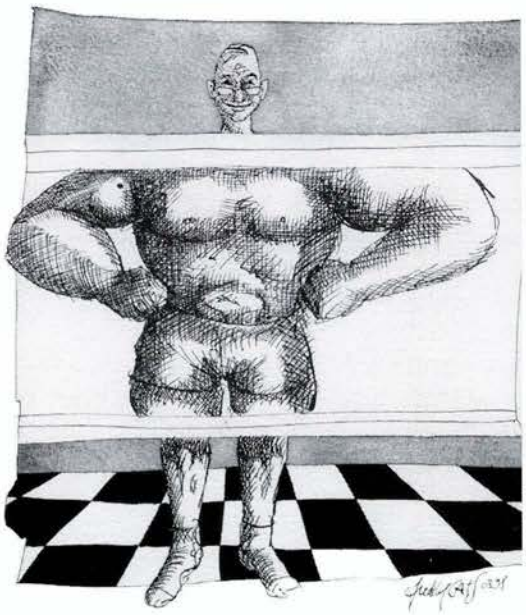
The availability of such benefits before workers qualify for old-age pensions can only amplify the incentives to retire early: working for a year after the benefits become available means forgoing a year's worth of benefits and paying an extra year of contributions. Moreover, the common practice of crediting years of unemployment, special early retirement and disability in calculating pensions means that in most countries the pension is not affected and thus that there are no gains to offset the costs of contributions paid and benefits lost.

Empirical evidence confirms that the increases in the generosity of unemployment-related schemes – in terms both of benefit and of maximum duration – have promoted early withdrawals from the labour market. This correlation is particularly evident in Finland, the Netherlands and Portugal. Likewise, the introduction of special early-retirement systems in the late 1970s and early '80s – in Austria, Belgium, Denmark, France, Italy, Spain and the United Kingdom – contributed to reduce the participation rates of the elderly. By way of confirmation, the closing-down of such systems in some countries (for instance, Belgium, Germany, the United Kingdom) in the late 1980s had the opposite effect. Hardly surprisingly, the variation between countries in these implicit tax rates on continued work between 55 and 64 – from both pension and other income-support schemes – is closely related to the cross-country variation in the average retirement age (Figure 2).

3. Such a criterion was written into law in several European countries (for example, Finland, Italy, the Netherlands, Sweden) in the 1970s; court rulings established it in others (Germany, for instance); and others yet (Austria, Norway) applied it in practice without any explicit basis in law.

What Effect from the Labour Market?

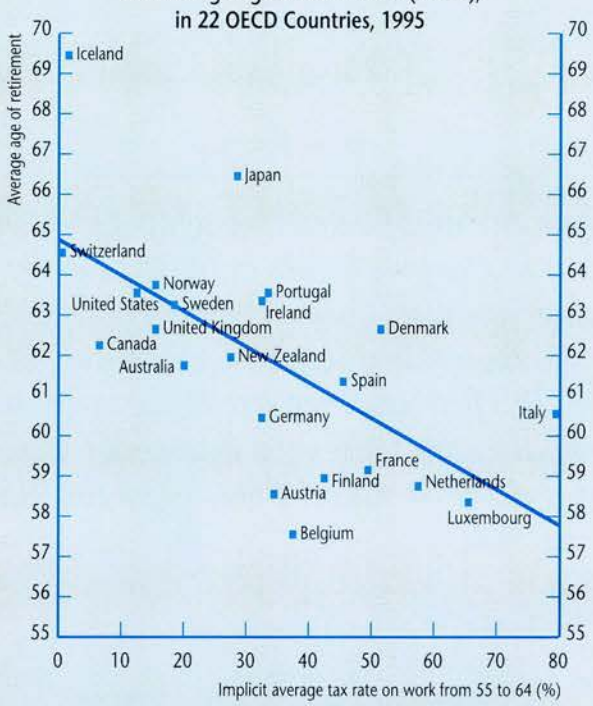
Growing unemployment, particularly among older workers, has amplified the impact of social-security systems on the decision on when to retire – on occasion perhaps even stimulating the policy changes aimed at easing the withdrawal of older workers from the labour market. Indeed, evidence indicates that the marked increases in structural unemployment in (mostly European) OECD countries have severely discouraged older workers. Likewise, the entry into the active life of the large – and generally better educated – baby-boom generation seems to have crowded-out job opportunities for the elderly and thus fostered their early retirement. These phenomena have been particularly evident in countries where wage rigidities prevented the labour market from adjusting fully.


Freddy Cats

The demographic bulge?

Early retirement is often concentrated in declining or slow-growing sectors (manufacturing,

Figure 2
Implicit Tax Rates[1] on Continued Work and Average Age of Retirement (Males), in 22 OECD Countries, 1995



1. The implicit tax rates take into account incentives in both old-age pension and unemployment-related benefit systems.
Source: OECD

mining and construction are examples); and there is a clear tendency for workers with a low educational attainment or qualifications to leave the labour market earlier than those with a higher education. To the extent that higher education enables workers to have access to more stable jobs, this evidence indicates a relationship between job-security and the decision to retire. They also support the idea that preference for leisure may depend on the satisfaction individuals derive from working at later ages.

The changes in social-security systems have made early retirement a 'soft option' in dealing with employment difficulties. For older individuals facing redundancy and insecure employment prospects, going into early retirement is an attractive alternative to maintaining a precarious foot-hold in the labour market. And employers who have to reduce their workforce find that early retirement has become a socially accepted way of doing so. And as retiring early has become a social norm, labour markets have gradually lost their capability to respond to the demands of older workers wishing to work (they require, *inter alia*, more flexibility in wage settings and in working-time arrangements). The reforms of social-security systems that are underway or proposed may thus have to be accompanied by changes in labour-market policy to promote flexibility in wage and working-time arrangements.

■ ■

Several OECD countries are indeed in the process of phasing-in changes to their pension systems or have decided on major changes, although they have not yet started the implementation phase. The main motivation has been cost-containment and fiscal balance in the face of ageing populations. Yet the adjustments have had, or will have, major effects on retirement incentives embedded in pension systems. The increase in the standard age of entitlement to a pension in, for example, France, Italy, Japan and the United States will tend to reduce disincentives to work. So, too, will the increase in pension accrual rates because of an extension (in France and the United Kingdom, for instance) of the contribution period required for full pension rights: continued work will be rewarded in higher pensions. The introduction of accrual adjustments for early access to pensions (as in Germany) and bigger rewards for deferred access (again as in Germany and also, in this instance, the United States) will also encourage people to stay in work. On the contrary, the increase in pension-contribution rates in Japan will discourage continued work, since an additional year of work will mean higher costs.

The net impact of the different changes on work incentives is likely to be beneficial, although not enough to eliminate the bias against work. Some countries therefore plan further overhauls to reinforce the relationship between pensions and contributions. Italy, for example, intends to transform its pension system into a fully contribution-based, and thus neutral, one; the new arrangements should be fully implemented by 2035 and, thus, their effects on retirement will only gradually emerge.

The conditions of eligibility for early retirement are also in the process of being tightened in a number of countries, chiefly for disability benefits (Italy and the Netherlands, for example), where increased emphasis is being placed on medical factors in assessing entitlement. In the first phase of these reforms, considerations of equity have often exempted older recipients of benefits from the new, stricter criteria; in the long run the reforms should nonetheless encourage older workers to stay on at work. But these reforms will not be successful if the tightening of one benefit system simply encourages would-be retirees to leave the workforce under the umbrella of other benefits. ■

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Can We Afford to Grow Old?

Glenn Cooper and Peter Scherer

The demographic changes wrought by ageing – as comparatively youthful working-age populations give way to proportionally smaller, older workforces with a higher proportion of retired elderly – have made the sustainability of public pension programmes a central concern for governments. All OECD countries have a 'retirement-income package' for their elderly citizens, consisting of a public pension augmented by income from other sources. But just what resources are available to a household of retirement age, and how do they compare with those of a household whose head is still of working age? The OECD has conducted a detailed study of this issue for nine member countries.[1]

In most OECD countries, many of the elderly have now achieved a high standard of living. Can this be sustained in the future as the population in OECD countries ages over the coming decades? Arriving at an answer requires some knowledge of the resources available to the elderly.[2] What proportion of their requirements is being met by further earned income, savings and accumulation of marketable assets, and to what extent is their standard of living supported by private and public pension schemes?

One measure of the 'adequacy' of resources available to the elderly can be derived by comparing the total disposable income available to a household in retirement with that enjoyed beforehand – a 'replacement ratio'. This measure shows what portion of a household's pre-retirement income will continue after retirement. A narrower version of the replacement ratio concept, the 'public-pension replacement ratio', compares only public transfers received during retirement to disposable income earned before retirement. But since all sources of income contribute to the financial well-being of the elderly, replacement ratios based upon total disposable income are more accurate. When they are used, replacement ratios yield fairly uniform results across countries and income distributions.

The existence of sizable differences between countries in the generosity of retirement-income packages,[3] viewed together with the relatively uniform replacement ratios, implies that individuals and their employers plan for their future by adjusting to institutional and market constraints and incentives in order to achieve some 'target' replacement ratio. This planning can include provision of employer-sponsored occupational pensions, increasing personal savings, investing in financial markets, or buying some housing or other property.

In countries where pension plans offer generous benefits, contributions by employees and their employers to

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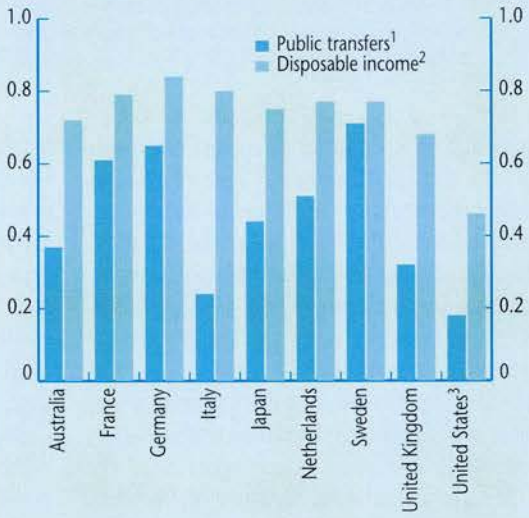
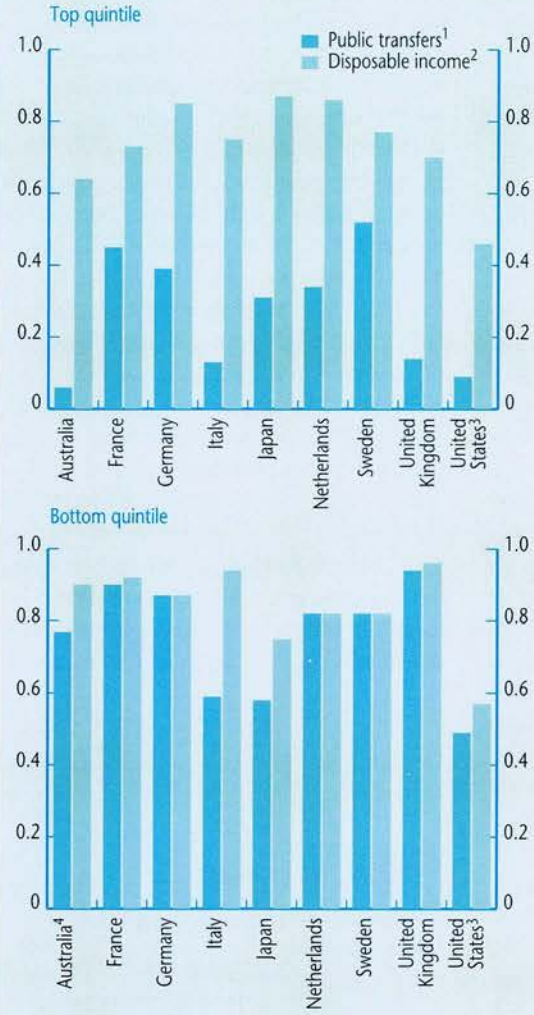
Figure 1
Replacement Ratios for All Households, 1997



1. Public transfers of households with head aged 67 relative to income of households with head aged 55.
2. Income of households with head aged 67 relative to income of households with head aged 55.
3. Ratios are for incomes before tax, and therefore biased downwards.
Source: OECD

Figure 2
Replacement Ratios for Households, 1997



1. Public transfers of households with head aged 67 relative to net income of households with head aged 55.
2. Aggregate net income of households with head aged 67 relative to income of households with head aged 55.
3. Ratios are for incomes before tax, and therefore biased downwards.
4. Second quintile.
Source: OECD

public pension schemes are the main way in which people provide for their retirement: occupational pensions, savings and subsequent accumulation of marketable assets play less of a role in providing for the future resources of retirement-age households. Where pension schemes (public or occupational) offer less assistance, individuals tend to work longer as well, accumulating increased savings for their own future requirements.

Figure 1 shows both measures of replacement ratios for couples: the comprehensive ratio which includes all components of disposable income[4] and the public-pension replacement ratio. There is more variation in the ratios between countries when only public transfers are considered. In the United States, where public transfers (largely social-security pensions) play a less important role in the income of the elderly households, the estimated replacement ratio is below 0.2.[5] In other words, American families, on average, have an income before retirement which is 5 times larger than the public pension. In countries such as France, Germany and Sweden, where earnings-related public-pension schemes play a more integral role in the resources enjoyed by the elderly, families have, on average, an income before retirement that is only about 1.7 times higher than the public pension.

International differences are less pronounced when considering all sources of income and taxes. For most comparable countries, these comprehensive replacement ratios cluster around 0.7. In countries with low public pensions, families and employers compensate for this through other sources of income in retirement.

An aggregate view of household earnings before retirement disguises a wide range of different circumstances. For most countries, earnings from work account for the largest part of income at this age – although people in the lowest fifth of the income distribution are often dependent on public transfers.

The relation between total net incomes before and after retirement is similar for all income groups. One way to see how this comes about is to look separately at the average replacement ratios for the couples in the wealthiest fifth of the population (the 'top quintile') and those in the poorest (the 'bottom quintile'). Figure 2 shows that for couples in the top quintile, public transfers play a very minor role in the financial situation of the elderly in Australia, Italy, the United Kingdom and the United States, where the replacement ratio can be as low as 0.1. In France and Sweden, by contrast, the replacement ratios for public transfers are around 0.5 even for this affluent group, meaning that public transfers after retirement account for 50% of their pre-retirement income.

If one compares total post-retirement to pre-retirement disposable income available to couples in the top quintile, there is much less variation across countries. For all of them, except

Growing old together

*1. **Maintaining Prosperity in an Ageing Society**. OECD Publications, Paris, forthcoming 1998. The countries that participated in the study are Australia, France, Germany, Italy, Japan, the Netherlands, Sweden, the United Kingdom and the United States.*

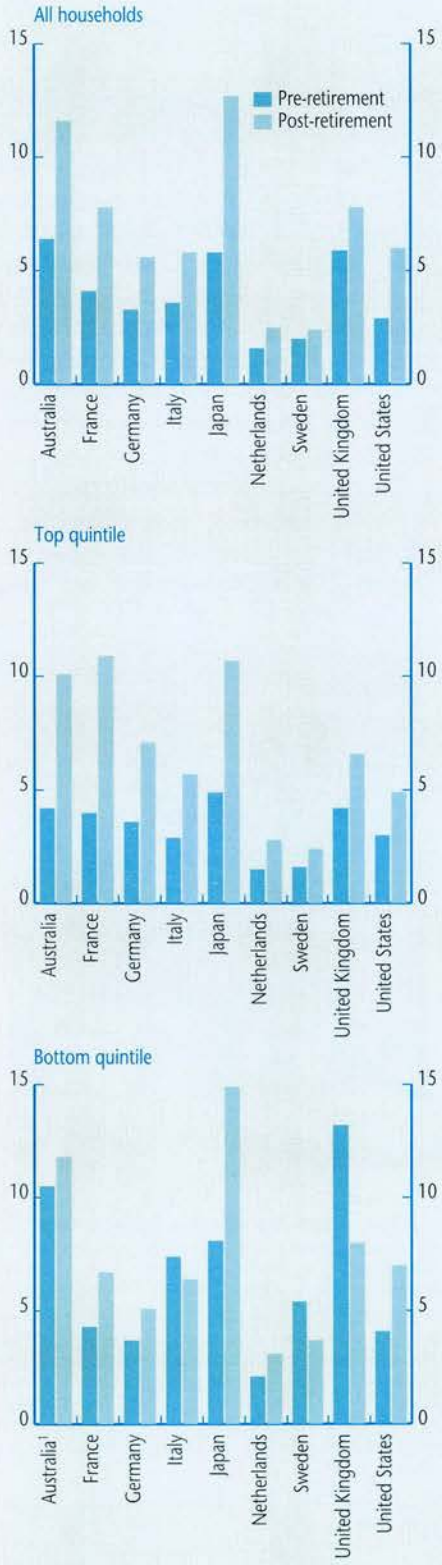
2. For analytical purposes, the OECD has disaggregated 'the elderly' into two age groups: pre-retirement (households headed by a 55-year-old) and post-retirement (households headed by a 67-year-old). The data collected reflected this breakdown, which refers to two different groups of households, not the same households viewed over time.

3. See pp. 15–19.

4. 'Disposable income' is defined as the sum of income from wage earnings, self-employment and capital, and public and other transfers.

5. Data for the United States refer to pre-tax income; estimates of replacement ratios therefore tend to be biased downwards since retirement income tends to be taxed less than income earned while working.

Figure 3
Wealth-to-Income Ratios
Pre- and Post-retirement, 1997



1. Second quintile.
Source: OECD

the United States, these ratios range between 0.7 and 0.9, meaning that a couple, once retired, can expect to continue receiving 70 to 90% of pre-retirement income. Considering that living expenses often decrease after retirement, these figures can translate into increases in the standard of living of the elderly.

For couples in the bottom of the income range, public pensions play a much more important role: for example, they provide 70 or 80% of the income that a retired couple in the bottom quintile received before retirement. For low-income families it is public pensions that ensure, in most countries, that incomes are maintained after retirement. They ensure that the overall replacement ratios of disposable income for those in the bottom of the income distribution range between 0.7 and 1.0 for all comparable countries. Since the average pre-retirement income of those in the bottom quintile is low to begin with, these households could fall below the poverty line if these incomes were not maintained after retirement.

Income, of whatever origin, does not constitute the only resource available to the elderly, since they also have access to existing wealth, including housing and other assets accumulated through savings during their working lives. In all countries, housing accounts for the dominant share of such marketable assets. Nonetheless, there is still a large amount of variability in the degree of home-ownership across countries, and along the income distribution.

Figure 3 shows the ratios of total market wealth to income for households before and after retirement. For couples that are not yet of retirement age, the ratios range from about 2 in the Netherlands and Sweden to about 6 in Australia and Japan. Such ratios rise substantially for most countries after retirement age. The increase is due to decreased incomes coupled with increased market wealth, including further savings by households before retirement and 'lump-sum' retirement bonuses received in some countries.

■ ■

For many people, ageing used to conjure images of having to make-do with less, and learning to get by with substantial decreases in income once they retired, leading them to wonder how they would get by. Pension systems in the OECD countries have turned this position around. The elderly today benefit from sometimes generous pension schemes, which ensure their financial well-being. The drawback is that these schemes place a severe burden on the working-age population, a burden which, in some countries, has become too heavy to manage. OECD governments are now being forced to look at ways of reducing public spending, including methods for reducing the generosity of public-pension regimes for which alternative solutions will be necessary. Such alternatives include encouraging private-funded pensions, promoting increased personal savings and expecting individuals to plan for their own retirement. However, this change of emphasis must be carefully planned so that the situation of poorer families is protected, as for them public pension benefits often mean the difference between poverty and a decent standard of living in retirement. ■

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Pension Funds and Financial Markets

Hans J. Blommestein

The importance of funded pension systems is growing and the move away from 'pay-as-you-go' pension systems administered by the state, in particular in countries where they are still dominant, is gathering pace. As a result, the financial assets of pension funds have grown dramatically, and their impact on the world's financial markets is increasingly attracting the attention of policy-makers.[1]

It is widely recognised that the development of funded pension systems should be supported by the simultaneous strengthening of the infrastructure of the financial market. The ability of pension funds to maintain living standards during the retirement of the contributors is indeed crucially dependent on the performance of financial markets. Consequently, the expansion of a funded-pension sector requires a sophisticated and well regulated financial market. By the same token, funded pension systems are affecting financial markets and, indeed, the world economy as a whole.

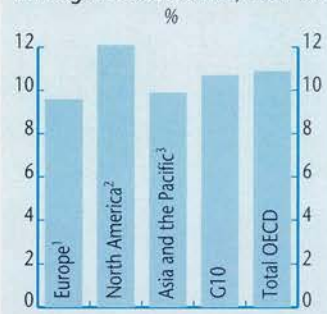
The magnitude of this effect can be gauged by examining the accumulation of retirement funds in relation to GDP. Total pension assets in the OECD area rose from almost 29% of GDP in 1987 to almost 38% (or around $8.7 trillion) in 1996. From 1990 to 1996 the average annual growth of asset holdings by pension funds was 10.9% (Figure 1).[2] But these aggregates hide a good deal of variation between individual countries: the figures range from 117% of GDP in Switzerland and nearly 90% in the Netherlands to 3–6% in France, Germany and Italy (Table 1). US pension funds grew by 12.5% in that period and those in Canada and the United Kingdom by rather less – 6.5 and 6.8%, respectively. Sometimes the difference is striking: Italian pension funds expanded by 37.8%, although from a very low base, and those in Germany by only 7.9%. The growth of Japanese pension assets has been 9.5%, and French pension assets had a growth rate of 13.3%.

This range provides a broad indication of the scope for further growth of pension-fund assets in countries with ageing populations but with relatively small pension funds (France, Germany and Italy are examples). Clearly, the potential impact on individual capital markets would be enormous if retirement assets grew from, say, 5% of GDP to the current OECD average of around 38% or, even more dramatically, to the US figure of around 60%.

The composition of the assets of pension funds also varies considerably. For example, pension funds in Belgium, the United Kingdom and the United States hold the majority of their assets in equities, whereas those in Germany and Italy invest largely in bonds. Patterns of holdings have been changing, although not uniformly across countries. Equity holdings of pension funds increased remarkably in 1990–96. The increase was largest in North America, with Asian-Pacific pension funds recording the lowest increase (Figure 2, p. 26).

Pension funds and other institutional investors involved in providing retirement income are affecting the financial markets through different kinds of 'financial intermediation' channels and functions, and the marked rise in cross-border transactions by pension funds means that these intermediation functions are carried out more

Figure 1
Assets of Pension Funds, Average Annual Growth, 1990–96



1. Excluding Finland and Iceland.
2. Canada, United States.
3. Australia, Japan, Korea.
Source: OECD

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1. For a more general assessment of institutional investment, see pp. 37–42.

2. These figures understate the financial importance of population ageing and pre-funded systems because life-assurance companies and mutual funds are also involved in the production and sale of retirement-income products. Unfortunately, for many OECD countries, there are not enough data to quantify their aggregate importance for financial markets.

Pension Funds and Financial Markets

Table
Assets of Pension Funds in OECD Countries, 1987–96
% of GDP

	1987	1990	1992	1994	1995	1996
Australia	..	17.6	23.9	30.3	31.4	31.6
Austria	–	–	0.5	0.8	0.9	1.2
Belgium	2.4	2.5	2.5	3.1	3.7	4.1
Canada	26.4	30.0	32.8	37.7	41.0	43.0
Czech Republic	–	–	–	0.1	0.2	0.5
Denmark[1]	10.9	12.4	16.6	18.9	21.1	23.9
Finland[2]	19.7	25.1	34.7	39.3	39.6	40.8
France	..	3.4	3.2	3.8	4.3	5.6
Germany[3]	3.4	3.3	5.1	5.4	5.2	5.8
Greece	..	6.5	6.9	10.3	10.9	12.7
Hungary	–	–	–	0.2	0.2	0.2
Iceland	..	..	..	..	..	..
Ireland	..	31.5	30.6	38.9	40.5	45.0
Italy	..	..	1.1	2.2	2.6	3.0
Japan	38.0	37.4	37.3	49.4	40.6	41.8
Korea	3.2	3.1	3.2	3.3	3.1	3.3
Luxembourg	19.5	19.7	18.8	20.3	19.6	19.7
Mexico	..	..	..	..	..	..
Netherlands	45.5	78.4	72.1	85.0	86.6	87.3
New Zealand	..	..	..	..	..	..
Norway	3.8	4.6	4.7	6.6	6.6	7.3
Poland	–	–	–	–	–	–
Portugal	..	1.9	2.9	7.3	8.0	9.9
Spain	–	1.5	2.9	2.3	3.1	3.8
Sweden[4]	33.4	31.0	29.6	25.7	30.5	32.6
Switzerland	74.7	72.5	74.7	86.5	104.3	117.1
Turkey	–	–	–	–	–	–
United Kingdom	62.3	59.7	58.2	69.2	73.2	74.7
United States	35.7	38.1	48.2	50.6	58.9	58.2

.. not available
– nil or negligible
1. Including company pension funds as from 1995.
2. Financial assets.
3. Including company pension funds as from 1992.
4. Including first pillar assets up to 1992.
Sources: Pragma Consulting and OECD

and more on an international scale. The size of pension funds has also had an impact on the structure of financial markets: countries with large funded pension schemes tend to have highly developed securities markets; in countries with small pension-fund sectors, capital markets are relatively underdeveloped (the equity market in particular).

Small differences – even of 1 or 2 percentage points – on the return of pension-fund assets can make an enormous difference both to contribution rates and to retirement benefits over a life-time. The potential impact of regulations on pension-fund investments therefore becomes an essential issue for the financial performance of funded systems.[3] A second – but equally essential – issue for policy is the influence of the financial-market infrastructure on the ability of pension funds to implement investment strategies in accordance with planned or desired risk-return profiles.

It is difficult to quantify the precise impact of the different dimensions of the regulatory structure on the investment performance of pension funds. But by comparing the aggregate returns on pension-fund portfolios in countries with 'prudent man' investment rules[4] with those of countries with quantitative restrictions, one can get a broad or rough indication of the performance of the industry that manages pension funds.

Financial returns covering recent periods show that pension funds in countries using the 'prudent man' rule outperform those where there are quantitative limits on investment, although it has to be recognised that other structural factors also affect the performance of pension funds. Thanks in large part to booming stock markets in most industrial countries (Japan is a notable exception) the difference in financial returns between the two groups widened from 2.6 percentage points in 1984–93 to 4.3 in 1994–96.

A well-functioning funded pension system requires a stable and efficient financial-market infrastructure: the legislative framework; the system of regulation and supervision; the financial-accounting system; clearing and settlement systems; and the micro-structure for trading securities. Most industrial countries have made considerable, if uneven, progress in the development of a capital-market infrastructure, including a solid regulatory and supervisory framework. Differences in disclosure requirements among countries are marked, partly because of different legal systems. In most emerging markets, the ability of regulators to monitor and enforce disclosure is weaker than in more mature markets. And recent events in South-East Asia demonstrate that a weak financial-market infrastructure, coupled with lack of transparency and accountability as well as inadequate disclosure standards, can prolong or exacerbate a confidence crisis. Indeed, to regain the trust of international investors, several Asian governments have stepped-up their efforts in strengthening disclosure requirements and reforming financial markets generally.

Risk Management and Regulation

The 'fundamental' principle of risk-management as applied to the allocation of pension-fund assets is that benefit security is maximised when the maturity and unit of account of assets are completely matched to deliver promised pension benefits. But higher returns can be obtained only by taking on higher risk, which requires a deviation from this principle. The asset-managers of pension funds, both inside and outside the firm, therefore have to adopt integrated and sophisticated risk-management systems that carefully define the investment risks in relation to the expected liabilities of the pension funds. Regulation should take account of the extent to which the implementation of standards for sound risk-management for pension funds can be linked to a relaxation of regulatory constraints on the allocation of assets.[5]

The implementation of risk-management systems, in turn, requires the adoption of a proper risk-accounting framework. Analysts have suggested that financial accounting requires a fundamental overhaul to allow the inclusion of various aspects of risk. Indeed, in practical terms financial risk-accounting is already being undertaken. Financial firms that deal extensively in

complex securities have developed risk-accounting protocols as part of their internal management systems. With the benefits of real-world experience, these protocols could serve as prototypes for a new branch of standardised risk-accounting.

Pressures on Prices

Concerns have been expressed that the growing demand for high-quality private securities (equity and corporate bonds), associated with the growth of advance-funded pension systems in search of investment opportunities (thereby increasing the demand for financial assets) and falling public-sector borrowing requirements (thereby reducing the supply of government securities), would put strong upward pressure on the prices of financial assets. Here, the combination of the widespread privatisation of state-owned enterprises and reform of pension systems brings the opportunity of killing two birds with one stone. Pension reform, which would increase the demand for equity, and privatisation, which expands the supply, simultaneously permit a more balanced growth in private securities markets, at least over the medium term.

In a somewhat longer-term perspective, population ageing may have an impact on the risk-premium (that is, the difference between the returns on stocks and the yield on bonds). Because asset preferences vary across age-groups, the ageing of the baby-boom generation could affect both absolute and relative positions of stock and bond prices. On average, middle age is the portion of the life cycle when saving rates are highest.[6] Moreover, middle-aged workers generally are more able and willing to hold a riskier portfolio; that is, one weighted more heavily towards stocks than bonds.[7] This is a consequence of two factors: first, while still working, a stockholder is better able to make up for any bad equity returns; second, middle-aged workers have a longer time-horizon and thus are willing to accept more risk in exchange for the expectation of higher returns. In this case, the ageing of OECD populations will tend to increase the price of stocks and bonds, decreasing their rates of return. Moreover, higher demand for stocks relative to bonds should increase the price of stocks relative to bonds, thus decreasing the equity premium.[8] After the baby-boomers begin to retire, saving rates would tend to fall, stock and bond prices to decline, and the equity premium to rise as baby-boom retirees shift their portfolios away from stocks toward bonds.

In a protracted period of depressed asset prices and returns, even the most prudently managed pension fund might find itself in difficulty. The danger that large numbers of investors might find themselves deprived of adequate income on retirement might once again generate pressure on governments to intervene, as they have done in the recent past. Potential problems of what economists call 'moral hazard' mean that there is a delicate trade-off here between individual and collective interests.[9] Setting-up an explicit system of government pension-guarantees, for example, might inadvertently encourage excessive risk-taking or inadequate funding by private pension sponsors.[10] The experience of policy-makers in the design and operation of deposit-guarantee systems is especially relevant in this context, as the same 'moral hazard' risk of encouraging irresponsible behaviour is present.[11] In any event, the likelihood of a government 'bail-out' in extreme circumstances suggests that regulatory oversight is desirable.

Investing in Emerging Markets?

The growing institutionalisation of savings, driven in large part by population ageing and pension reform in the OECD countries, has provided an important stimulus for sustained flows of private capital to emerging markets. The scale of flows in the 1990s from the 'older' OECD area to the 'younger' emerging markets and the broadening of market access confirms the increasingly rapid integration of the world's financial markets. In 1996, for example, net flows of private capital grew by 22% over the previous year, to a record figure of $235 billion. Since efforts to liberalise cross-border financial flows are continuing, as also to develop and to strengthen capital markets in the countries receiving these flows, this trend is likely to persist as OECD pension funds and other large institutional investors increase their exposure to emerging markets and diversify their portfolios more widely.

At the moment, only a relatively small portion of pension-fund assets in OECD countries is invested overseas. Among G10 countries, for example, only pension funds in Belgium, the Netherlands and the United Kingdom hold foreign assets on any scale, of which just a small

3. See pp. 10–14.

4. A number of countries do not impose quantitative limits but impose guidelines such as the so-called 'prudent-man rule' or 'prudent-person principle'. Under the prudent-man rule, fiduciaries, trustees and bank trust departments are expected to behave as careful professionals in making investment decisions – as in the United States under the Employment Retirement Security Act (ERISA). 'Prudence' is a design standard, not a performance standard. This is reflected in the two most important elements of the rule: the requirement to diversify and the exhortation to favour 'seasoned' situations that similarly placed institutions find appropriate.

5. There is an interesting parallel here with the discussion on the balance between capital-adequacy standards for banks and the supervision of their in-house risk-management systems.

6. This type of saving behaviour is a feature of both a theoretical life-cycle model and, more importantly, the type of saving behaviour seen empirically in household data.

7. The real return on United States stocks, for example, averaged 9% over the period 1947–96 with a standard deviation of 17%. This implies that there is about a 30% probability of a decline bigger than minus 8% or a rise bigger than 26% in any given year. The average real return on long-term United States government bonds over 1953–96, however, is much lower – 3% – but also less volatile – these returns have a standard deviation of 2%.

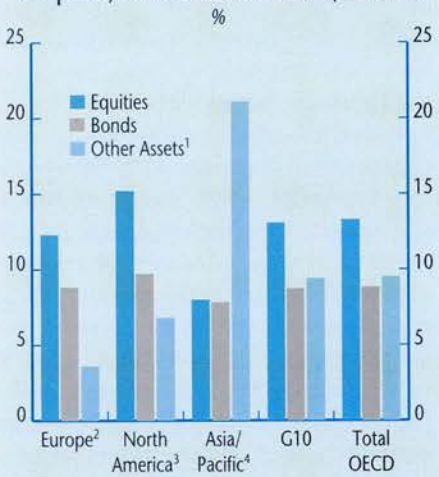
8. It is generally held that risk aversion increases with age (holding length of life constant). Thus, some have hypothesised that an ageing population would cause the equity premium to increase. But if the age of the population is increasing at least in part because life span is increasing, and thus time horizons are lengthening, then the ageing of the population does not necessarily imply that average risk aversion should be increasing and risk premium on stocks should be rising.

9. A detailed analysis of this issue can be found in R. C. Merton and Z. Bodie, 'On the Management of Financial Guarantees', Financial Management, *Winter Issue, 1992.*

10. Z. Bodie and R. C. Merton, 'Pension Benefit Guarantees in the United States: A Functional Analysis', in R. Schmitt (ed.), The Future of Pensions in the United States, *University of Pennsylvania Press, 1992.*

11. Z. Bodie, 'What the Pension Benefit Guaranty Corporation Can Learn from the Federal Savings and Loans Insurance', Journal of Financial Services Research, *Vol. 10, 1996.*

Figure 2
Pension Funds: Average Annual Growth Rate of Equities, Bonds and Other Assets, 1990–96



1. Including non-financial assets, cash, loans and other financial assets.
2. Excluding Finland and Iceland.
3. Canada, United States.
4. Australia, Japan, Korea.
Sources: Pragma Consulting and OECD

part is invested in emerging markets. In those G10 countries with substantial pension-fund holdings (Belgium, Ireland, Japan, Netherlands, Switzerland, United Kingdom, United States), the share of foreign assets increased from 12% in 1990 to 17% in 1996.

Surveys suggest that US pension funds and mutual funds currently have about 2% of their assets invested in emerging markets. The figure for UK pension funds and mutual funds is somewhat higher (3–4%). Japanese and continental European institutional investors have negligible emerging-market assets in their portfolios. All the evidence points to the fact that all types of institutional investors are much less internationally diversified than the world market portfolio, where countries would be weighted in proportion to the importance of their financial markets in the world economy. Pension-fund portfolios in particular display a strong domestic bias.[12]

On the other hand, the trend of investing in foreign markets is supported by the growing influence of the fund-management industry, which is leading to a more professional attitude towards international fund allocations. The ageing of OECD populations and the resulting growth of pension-fund and other institutional assets have increased the demand for the services of professional fund-managers, whose investment and trading strategies in turn have a considerable influence on the operational aspects of financial institutions and markets. And a central strategic feature of pension investment is portfolio diversification.

The Pros and Cons of Diversification

Diversification aims to improve the ratio of risk to return, and a number of studies indicate that international diversification brings particular benefits.[13] Arguments based on demographic trends have been advanced to suggest why, in principle, it would be beneficial for OECD pension funds to invest in the younger, non-OECD economies. But there are risks and costs in this strategy. A number of factors (including investment-risk related to poor financial infrastructure, political risk, the impact of capital exports on OECD security prices, financial fragility in emerging markets) reduce the potential benefits.[14] To some extent, these concerns can be addressed by investing in securities issued by multinational companies or through the use of swaps and other derivative securities. Indeed, the development of global markets for swaps and derivatives makes possible the linking of diverse national systems to exploit new opportunities for the efficient international transfer of risks as well as resources. In this way, countries can retain the capital resources invested by their own pension funds, and yet gain the benefits of international pooling of risks through such devices as international equity swaps.

But a closer look at stock-market returns and equity risk in emerging equity markets gives grounds for caution. Although in 1985–95 the industrialised countries have tended to grow more slowly than the developing or emerging economies, this pattern has not been uniformly reflected in stock-market returns. In that time, indeed, the G7 stock markets have given better returns than the emerging markets: the 'Standard and Poor 500' equity index has produced better returns per month than the average of all the emerging market indices. The same is true of the last five years. Naturally, the future might bring better news in higher expected returns and/or lower risks, especially in the light of the expected ageing-induced pressures on financial returns in the OECD area and further improvements in the financial infrastructure in the emerging securities markets, as well as further development of their domestic institutional investors.

Diminishing Returns from Integration

By exploiting the fact that risks and returns on assets are not perfectly correlated, a portfolio with international assets can achieve more stability in returns without sacrificing the return overall. This insight has resulted in the adoption of asset-allocation rules based on international diversification. But more recent analyses have pointed out that the benefits of diversification are decreasing: growing financial integration is leading to an increase in correlation of returns – in particular on the bond markets and especially in those of western Europe – and thus circumscribing the potential for reducing risk on a bond portfolio through diversification.[15] Moreover, the fact that an increasing amount of institutional

12. The reasons for this bias are given in ***Financial Market Trends****, No. 68, OECD Publications, Paris, November 1997.*

13. For example, S. Heston and G. Rouwenhorst ('Does Industrial Structure Explain the Benefits of International Diversification?', Journal of Financial Economics, *August 1994) found that diversifying across countries, but staying within a single industry, reduces volatility more than diversifying across industries in a single country, even though both portfolios carry the same average return.*

14. Hans J. Blommestein, 'Ageing-induced Capital Flows to Emerging Markets Do Not Solve OECD's Basic Pension Problem', in ***Institutional Investors in the New Financial Landscape****, OECD Publications, Paris, forthcoming 1998.*

15. C. Kessler, 'Diversification – Is It Still Alive?', Economic and Financial Prospects, *No. 6, Swiss Bank Corporation, December 1996.*

money is managed using diversification is bringing diminishing rewards.

The high correlation of returns between countries has in some cases led to a restructuring of portfolios by diversifying by sectors. The correlation between OECD stock markets and equity markets in emerging countries has likewise increased and, therefore, the risk-reducing benefits of international investments have become less powerful. They can nonetheless still be enjoyed, also during sharp downside moves of securities markets.

Freddy Cats

Savings and investments

Although the expectation is that the trend of investing in emerging markets by pension funds will continue,[16] abrupt loss of access by individual countries to the global capital market will probably still occur: there are the recent examples of Mexico in 1994–95 and several South-East Asian countries in 1997–98. This cyclical variability in capital flows can be ascribed to two main factors: divergent macro-economic conditions in capital-exporting and -importing countries, and crises in individual recipient countries.[17]

Uncertainties about the sustainability of macro-economic policies and weaknesses in the financial infrastructure increase the risk that the currency of the capital-importing country will be 'tested' through a sustained attack, leading to a sudden drying-up of capital inflows and major capital outflows.[18] Indeed, financial integration, driven by population ageing and other structural factors, has also increased the potential intensity and duration of such periods of financial-market turbulence. There is also evidence that pension funds and other institutional investors at times play a crucial role in determining asset prices in emerging financial markets, with shifts in sentiment resulting in periods of bubble-like booms and busts and highly volatile financial markets.

Recent destabilising shifts in international capital flows have drawn attention to the following areas where urgent policy-actions in emerging markets are required to prevent future currency crises and 'contagion' effects:

- strengthening of the financial infrastructure, including regulation and supervision
- consistency between the exchange-rate regime and macro-economic and financial policies
- implementation of better, internationally acceptable risk-management standards and practices by pension funds and other institutional investors
- developing and applying high standards of accounting, transparency and financial reporting
- an improvement in disclosure standards so as to reduce uncertainties for international and domestic investors.

The implementation of these structural reforms is essential for making investing OECD retirement funds in non-OECD countries more attractive.

■ ■

The development of advance-funded pension systems should go hand-in-hand with a strengthening of the financial market infrastructure, including the establishment of a modern and effective regulatory framework.

The productive, safe investment of retirement savings requires well-functioning capital markets. The supporting infrastructure involves legislation and codes of conduct, internationally acceptable accounting standards and disclosure rules, proper pension-asset investment rules and co-ordination among the different regulatory and supervisory agencies involved in the provision of retirement income. A competitive mutual-funds and asset-management industry is required to minimise the costs of managing retirement assets. All of these elements have to reflect the realities of the new financial landscape.

Emerging market economies should implement radical structural reforms – not least of their financial markets – so as to make the investing of OECD retirement funds in non-OECD countries more attractive. ■

16. The World Bank estimates that pension funds and other institutional investors can continue to increase expected returns and reduce overall risks until the share of their portfolios allocated to emerging markets reaches a volume that is three times as high as it is today (Private Capital Flows to Developing Countries, *Washington DC, 1997).*

17. The International Monetary Fund concludes that despite all the structural changes that have occurred in the new financial landscape, the potential sources of cyclical variability remain the same (International Capital Markets, *IMF, Washington DC, 1997).*

18. Private-sector capital flows to emerging markets fell from $295.2 billion in 1996 to $199.6 billion in 1997 – a figure entirely accounted for by the five Asian countries hit hardest by the recent crisis (Indonesia, Korea, Malaysia, the Philippines and Thailand) which suffered in 1997 a net outflow of $12 billion, compared to a net inflow of $93 billion in 1996.

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Water, Agriculture and the Environment

Gérard Bonnis and Ronald Steenblik

Crops and fodder need water to grow, lots of it. As a rough indication, a kilogram of potatoes takes up to 500 litres of water to produce, a kilogram of grain-fed beef up to 100,000. Throughout most of the world, and in many rural areas of the OECD, agriculture is the leading consumptive user of water. How are OECD governments responding to the increased demand for water in agricultural production and the growing public awareness of the impact of agriculture on the environment?[1]

Agriculture uses a lot of water. Withdrawals for agricultural purposes currently account for 50% or more of total abstraction in at least nine OECD countries (Greece, Italy, Japan, Korea, Mexico, New Zealand, Portugal, Spain and Turkey), and for over a third in five others (Australia, Denmark, Hungary, the Netherlands and the United States). But because of losses through evaporation and plant transpiration, the share of agriculture in total water consumption is usually much higher. In North America and OECD Europe, for instance, it accounts for between 37 and 45% of total withdrawals, but around two-thirds of consumption. In drier parts of the OECD area, such as California, and the Murray-Darling basin in Australia, agriculture accounts for well over 90% of consumptive use.

Irrigation has allowed the expansion of agriculture into semi-arid and even arid environments, thus helping to stabilise the revenues from farming. With the exception of crops with low value-added (like alfalfa), irrigation can bring substantial economic gains: though only about 20% of arable cropland in the OECD countries is irrigated, its share of the gross value of agricultural production is somewhere in the neighbourhood of 40%. To some extent irrigation has also helped with risk-management, thus reducing pressures on government to provide disaster payments to compensate for crop losses as a result of periodic droughts.

The major share of the costs of investments in irrigation falls on the taxpayer, other water-users and electricity consumers (through cross-subsidies). And it is, in the main, national treasuries that have financed dams, reservoirs and delivery networks as well as a large part of the cost of installing local and farm infrastructure, including drainage pipes. Governments generally attempt to recover some of these costs through user-charges, but revenues are rarely enough to cover even operation and maintenance costs.

The economic distortions caused by the often enormous underpricing of surface water used in agriculture have been compounded in many instances by agricultural policies, particularly those linked to the production of particular commodities. Such linked support draws resources, including water, into the activity being supported, thereby driving up both the price of water to other users and the volume of agricultural subsidies. As a rule, farmers have free access to (or are charged only a nominal fee for) water that they pump themselves. And several countries (among others, Mexico, Turkey and the United States, at least in some Federal irrigation districts) continue to offer preferential tariffs for electricity used to pump water for irrigation.

Nowadays, governments in most OECD countries are scaling back large programmes to develop irrigation (Turkey is the major exception), as they run up against physical, if not financial, limits. The annual rate of expansion of irrigated area in the OECD has dropped to below 1% (compared with close to 3% in the late 1970s). But the exploitation of groundwater aquifers for farming continues to grow apace – not only in arid and semi-arid regions but in many humid areas as well. In the United Kingdom, for example, the volume of water abstracted for irrigation has more than tripled in the last 25 years, although from a small base.

Effects on the Environment

Water-use in agriculture has marked effects on the environment, not all of them adverse. Reservoirs created for irrigation can provide fresh water for birds and other fauna; terraces for growing rice can help slow down run-off and reduce erosion; water-management for agricultural purposes can replenish the water-table and stabilise river levels. Irrigation, moreover, allows the recycling of urban waste-waters – although such

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practices can lead to the transmission to man of water-borne diseases.[2]

The diversion of water for agriculture has often caused environmental problems and degraded natural resources. The steady flows that dams cause alter the seasonal cycles of aquatic and riparian plants and animals. Reduced stream flows and excessive use of groundwater aquifers lead to higher concentrations of pollutants. Excessive extraction can lower water-tables, leading, in some cases, to ground subsidence and, in some coastal areas, to salt-water intrusion. And because irrigation water almost always contains much higher concentrations of dissolved salts than rainwater, its discharge often raises the proportion of salts in the bodies of water into which it flows.

The depletion of aquifers for irrigation raises questions about the sustainability of some important farming systems. In the Texas High Plains of the United States, a major cotton, grain and beef production area, agriculture has been responsible for depleting one-quarter of the Texas portion of the massive Ogallala aquifer – an underground water body containing the run-off of several ice-ages – over the five decades to 1990.

Another threat to the sustainable management of agricultural land is the lack of adequate drainage, which farmers and governments also fail to provide because of its expense. The result too often is water-logging (the over-saturation of soils with water) and the build-up of salt in soils. In places such as the Iberian Peninsula, Australia and western North America, fertile lands have had to be abandoned due to salt encrustation, nullifying some of the gains that irrigation was intended to yield.

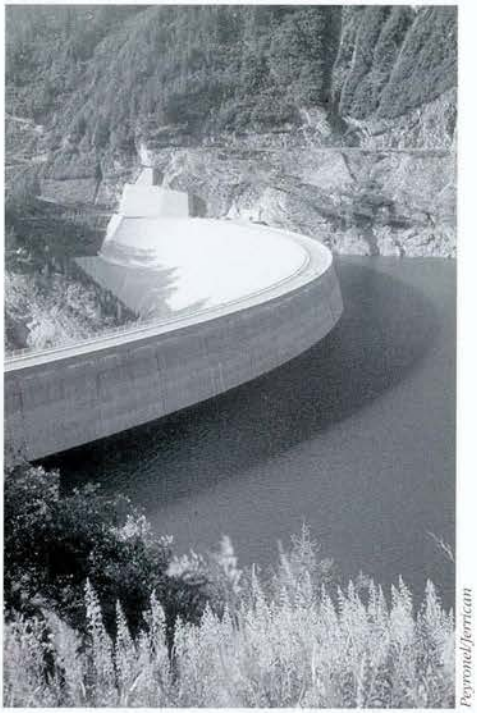
Problems arising from irrigation are not the only ones associated with water-management practices in agriculture. In Queensland, Australia, for example, the concentration of cattle around watering stations fed by artesian wells has degraded grazing land. In the Netherlands[3] and in parts of other OECD countries with low-lying farmland, the drainage of water to facilitate cultivation has had a profound effect on the flora and fauna. Generally, species adapted to wet conditions die out, to be displaced by those that prefer drier soils.

Adding to the general concern over the sustainable use of water are the uncertainties about the possible effects of global climate change. If temperatures were to rise substantially as a result of an enhanced greenhouse effect, both rainfall patterns and evapo-transpiration rates are likely to be affected: some areas of the OECD, such as northern Europe, could experience increases in rainfall, and others, such as Western Australia and Japan, could face declines. Clearly, any such changes would have major implications for agriculture, water and the environment. Decreases in precipitation in southern Europe could thus reduce crop yields and make irrigation compete even more fiercely with domestic and industrial water-use.

Steps towards Reform

The rationalisation of water-management arises in part from the desire of governments to reduce expenditure and improve economic performance – not to mention the necessity of managing natural resources in a manner that looks to the longer term. The authorities in some countries have therefore begun to examine means of reducing the role of the state in the construction, operation and maintenance of irrigation infrastructures and eliminating – or at least containing – hidden subsidies to the price of water.

One of the most fundamental reforms of water policy is taking place in Australia, following an agreement by the Council of Australian Governments in 1994 to implement a national framework for water reform by 2001 ('the COAG Framework'). For rural water-management, the Framework calls for, among other changes: pricing water based on transparency and full-cost recovery; setting up a comprehensive system of allocating water or entitlements to water-use distinguishing between property rights on water and on soil; allowing exchange of water-allocations and of entitlements to water-use within the social, physical and ecological constraints of catchments. In parallel, changes are proposed to the way that public water-supplies are managed, so as to ensure that natural wetlands receive adequate quantities at the right time.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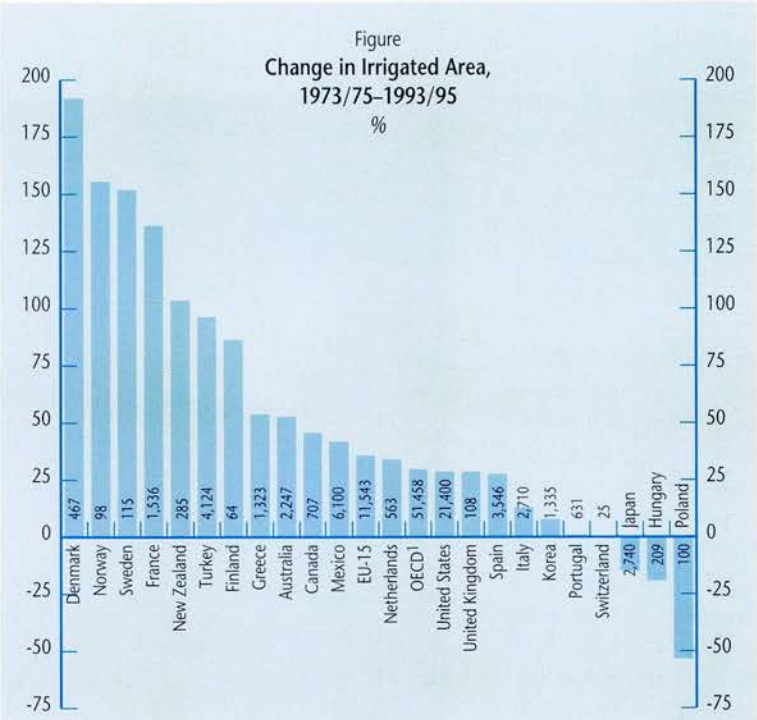
In many OECD countries, large-scale irrigation systems are managed by state-owned companies, but there is now a trend towards the partial or total devolution of authority towards organisations of irrigators. Accordingly, charges are now levied for services rendered (either through a standing charge or, more often, a charge by volume), with the aim of covering all or part of the operational costs. Another system of collective user-charges aims to optimise the use of the available resources, taking particular account of the requirements of natural habitats. But only a few of the OECD countries have implemented such charges.

1. ***The Sustainable Management of Water in Agriculture – The Athens Workshop***, *OECD Publications, Paris, forthcoming 1998.*

2. ***Biotechnology for Water Use and Conservation – The Mexico '96 Workshop***, *OECD Publications, Paris, 1997.*

3. ***Environmental Performance Reviews – The Netherlands***, *OECD Publications, Paris, 1995.*

Water, Agriculture and the Environment



1. Excludes Iceland and Ireland.
Values in each bar refer to the 1993/95 average of irrigated area in thousands of hectares.
Sources: FAO, OECD

How governments behave has a direct influence on how water is used in agriculture: where and how irrigation is used, on what scale and at what price. With the growing importance policy-makers are attaching to the sustainability of agricultural practices – to make sure that production is viable without long-term damage to the environment – the necessity of reforming water policies is becoming plainer still. The multiple points of contact between water, agricultural and environmental policies makes a global approach requisite.

The development of agricultural policies is combining with international obligations to bring new pressure behind reform. Until recently, water projects were often undertaken in the expectation that farmers could sell their crops and livestock at artificial prices sustained by border measures (customs duties and export subsidies). The choice is no longer available. The obligations to reduce both internal support and barriers to agricultural trade to which all OECD countries are bound by the 1995 Uruguay agreement and the reforms of agricultural policies to which they are committed is resulting in a much stronger market-orientation.

Governments are also helping farmers to adopt water-conserving practices or to clean-up their discharges of drainage water. In some cases, such changes involve technologies that deliver precise dosages of water to crops and livestock. In others, substantial gains in efficiency are being made simply by replacing open drains with plastic distribution pipes. Cattle-ranchers in Queensland, Australia, for example, used this kind of piping to increase the number of stock watering stations, thereby reducing damage to soils and dramatically cutting water losses from evaporation. In the Texas High Plains District, determined efforts to conserve water over the last decade have cut irrigation requirements by 25%, to 40%, raising hopes that the groundwater table may be stabilising. In Greece, simple methods for recharging coastal aquifers have helped stave off salt-water intrusion. Over the longer term, new developments in research are expected to improve the tolerance of crops to drought and salts, and even to improve the texture of soil so that it can retain more water.

Lack of reliable data – both physical and economic – remains a substantial impediment to the monitoring of progress towards the sustainable management of water in agriculture. In recognition of this shortcoming, expert groups at a workshop in Athens urged the OECD countries to work on developing a number of common national agri-environmental indicators. Three series of data – intensity of use, technical efficiency of use and economic efficiency of use – could be collected to measure the physical pressure from agriculture on water resources. A cost-recovery indicator would reflect the share of the full costs of supplying water to agriculture that is recovered from users, from farmers in particular. These indicators will be further analysed by the OECD with a view to agreeing on common methodologies.

■ ■

The management of water in agriculture requires more attention from policy-makers, and should be examined in a general framework for the sustainable use of water resources which also takes into account the demands of the environment. That calls for the introduction or reinforcement of systems that will allow charges to be levied and water to be allocated between users and beneficiaries (agriculture included), taking all of the economic and ecological costs and benefits into account. It is imperative that farmers be given the right signals to use water in the most economically and environmentally efficient ways. Considerable gains in efficiency could be realised through the upgrading and replacement of existing water infrastructure. But investment of this sort, particularly when it is paid for by the taxpayer, should be undertaken only after a thorough evaluation both of the economic viability and the environmental sustainability of the projects. Too often in the past, governments have shown a willingness to throw good money after bad. ■

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Counting Human Capital

Tom Healy

Investment in education and training helps form the human capital – the skills and abilities – that is a vital element in assuring economic growth and individual advancement and reducing inequality. It is an important element in combating unemployment and social exclusion. Some of the returns to this investment can be measured; others cannot, though they are no less important.[1]

With economic, social and technological change all calling for constant flexibility and adaptation, governments, organisations, enterprises and individuals alike are increasingly aware of the importance of lifelong learning; similarly, they share a common interest in renewing and increasing the skills base of the population. Tight fiscal constraints in almost all OECD countries compound the importance of efficient investment in education and training – and thus in human capital.

This investment encompasses not only the skills and knowledge acquired in the course of formal education. It also includes what is learnt at work, as well as informally in the family and elsewhere, outside organised training.

Any assessment of the efficiency of investment in education requires measurement of the returns that it yields. There is no shortage of data on the relationship between formal education and labour-market outcomes for individuals. But information is lacking in other crucial areas of human-capital investment, such as its social impact and the role of training and learning in a variety of environments after formal education. Moreover, the frequently-used operational definition of human capital as 'skills and knowledge acquired in the course of initial education' neglects other important aspects, not least non-cognitive or 'cross-curricular' abilities that are acquired outside formal settings but are nonetheless relevant to (for example) teamwork, problem-solving and civic responsibility.

A recent attempt to address this problem computes direct measures of literacy skills in the adult population. The OECD and Statistics Canada have co-operated in an International Adult Literacy Survey (IALS) to try to measure the incidence of particular work-relevant skills among the adult populations of 12 OECD countries: 'prose literacy', 'document literacy' and 'quantitative literacy'.[2] In each of the categories, respondents were required to use these skills to perform tasks that simulate situations they are likely to confront in everyday life, such as interpreting information from a medical prescription or a bus timetable. Individuals were placed in different categories according to their abilities: ranging from being able to locate a straightforward piece of information in simple written material to being able to perform complex tasks, combining several pieces of information drawn from written material.

Although there is no single cut-off point that defines whether a person is literate or not, the results of IALS show a worrying degree of under-performance in all the countries surveyed. Performance at 'literacy level' 3 out of a total of 5 is generally considered necessary in order to avoid difficulties in coping with social and economic life in a modern democratic society. Although those on levels 1 and 2 may be able to read and understand simple materials, they have difficulties with the more complex tasks that are now required of workers and citizens and the skills that they do have are unlikely to be sufficient to allow them to compete effectively in today's labour market.

Typically, between a third and a half of OECD adult populations – many of them in older age-groups – is likely to face substantial literacy problems. As expected, literacy is directly related to attainment in initial education (Figure 1), but there is considerable variation both at the same stage of educational attainment for each country and between countries. That suggests that educational attainment, although closely related to literacy, is not, on its own, a satisfactory proxy measure of human capital. Of the 12 countries surveyed by IALS to date, Sweden emerges as having the highest degrees of literacy and Poland the lowest. And some countries, such as Canada and the United States, show considerably more variation in literacy within the adult population than the others, indicating a more uneven distribution of human capital.

Investment in continuing education and training by the adult population gives some idea of the extent to which these countries are addressing their skill deficits. The table provides a comparison of the rates of participation in job-related training for ten of the countries participating in IALS.[3] Some countries with relatively low degrees of literacy show relatively more job-related training – although the differences were much less marked when the average duration of training was estimated rather than its incidence. In all countries, there is a concentration of such investment among younger, economically active,

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1. ***Human Capital Investment – An International Comparison***, *OECD Publications, Paris, 1998.*

2. ***Literacy Skills for the Knowledge Society – Further Results from the International Adult Literacy Survey***, *Human Resources Development Canada/Statistics Canada/OECD Publications, Paris, 1997. Results were published for Australia, Belgium (Flanders), Canada, Germany, Ireland, the Netherlands, New Zealand, Poland, Sweden, Switzerland (French- and German-speaking communities only), the United Kingdom and the United States. Results for a further 12 countries will become available towards the end of 1998.*

3. *Data on job-related training for two of the 12 countries participating in IALS, Germany and Sweden, were not usable.*

Counting Human Capital

FOCUS

The Social and Economic Benefits of Investing in Education

Not all the benefits of investment in human capital can be identified as additional earnings by individuals. A number of studies have found a direct connection between the proportion of the population with a given standard of educational attainment and long-term economic growth (allowing for the impact of physical capital). An OECD analysis estimated that secondary education had contributed an annual 0.6% to productivity growth in the OECD countries between 1960 and 1985.[1]

The evidence of additional economic output attributable to education has to be set against the cost of the investment. The World Bank has used cost-benefit analysis to calculate a 'social' rate of return to university education of well over 10% a year between 1960 and 1995 in the OECD countries.[2] *If such estimates prove robust, they will provide important confirmation that investment in human capital yields large pay-offs for whole economies and not only for individuals.*

Moreover, the creation of knowledge, skills and abilities relevant to economic activity affects not only performance at work but also social behaviour. There are important social benefits associated with higher educational attainment in terms of better public health, lower crime, the environment, parenting, political and community participation and social cohesion, although there continues to be debate about the direction of causality. There is clear evidence, for example, that better-educated people tend to be healthier, even allowing for the health benefits that they enjoy because of their higher income. Education also appears to lessen the risk of crime through helping to socialise young people who remain in school.[3]

1. A. Steven Englander and Andrew Gurney, 'Medium-term Determinants of OECD Productivity', **OECD Economic Studies**, No. 22, OECD Publications, Paris, 1994.
2. Alain Mingat and Jee-Peng Tan, The Full Social Returns to Education: Estimates Based on Countries' Economic Growth Performance, *Human Capital Development Papers, World Bank, Washington, DC, 1996.*
3. Jere R. Behrman and Nevzer Stacey (eds.), The Social Benefits of Education, *The University of Michigan Press, Ann Arbor, 1997.*

better educated people. Many groups for whom training would bring more immediate benefits are in practice less likely to participate, increasing their vulnerability in the labour market. It seems clear that neither the stock of human capital nor the pattern of investment is well distributed among the adult workforce.

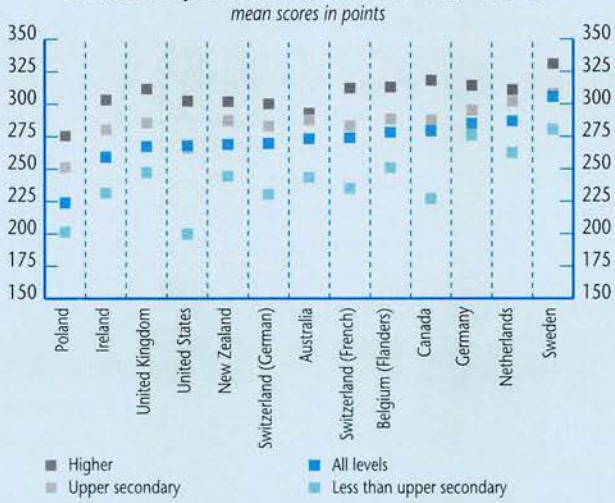
Measuring Returns

Investment in human capital accounts for at least 10% of national income in most OECD countries when account is taken of public and private spending on initial education as well as spending by individuals and enterprises on post-school training. Expenditure on such a scale raises important policy issues about what volume of spending is appropriate, how resources should be allocated between different types of investment in human capital (early childhood education, for example, as opposed to higher education), and how the cost is distributed (between companies, individuals or public authorities), including its incidence on those who receive the most benefits. These questions cannot be answered without reference to the total returns – monetary and non-monetary – to investment in different types of human capital and how they compare with investment in physical capital.

But rates of return of investment in human capital are generally measured in a very restrictive way, by comparing the additional earnings from employment of better-educated individuals to the additional social cost of investing in more education. Based on data from household-income surveys for 18 countries, Figure 2 shows some estimates of rates of return for women from upper-secondary and higher education. These show that, typically, for every extra dollar spent on university-standard education compared with spending on upper-secondary, the additional stream of earnings over a lifetime represents the equivalent of an annual rate of return of between 10 and 15%.

The returns tend to be higher in the case of upper-secondary graduates than for university graduates (the same pattern holds for both women and men), reflecting the higher costs of university education. Even though university education incurs a premium in terms of above-average earnings over the life-cycle over what would be earned after upper-secondary schooling, the relative expense of completing a university degree negates some of the additional benefit to individuals.

Figure 1
Adult Literacy and Educational Attainment,[1] 1994–95
mean scores in points



1. Mean document score on a scale with a range of 0–500 points, by level of educational attainment; persons aged 16–65; ranked by overall level.
Sources: Human Resources Development Canada, Statistics Canada and OECD, 1997

In each country, better-educated persons are on average more literate, but average literacy of individuals with the same educational level varies widely across countries.

These estimates can be compared with published data on rates of return to business capital. On the whole, returns to spending on education compare favourably (Figure 2). Returns to investment in upper-secondary education tend on average to be roughly equivalent to returns to business capital; returns to higher education tend to be slightly less, although the differences are relatively small. These estimates of returns to education nonetheless have to be qualified because they:

- take no account of the wider social and macroeconomic benefits of initial education
- do not take into account the impact of informal learning, job-experience and work-based training in the course of a working lifetime
- are based on assumptions about growth in earnings of different educational groups and cannot provide a forecast of how future earnings will evolve.

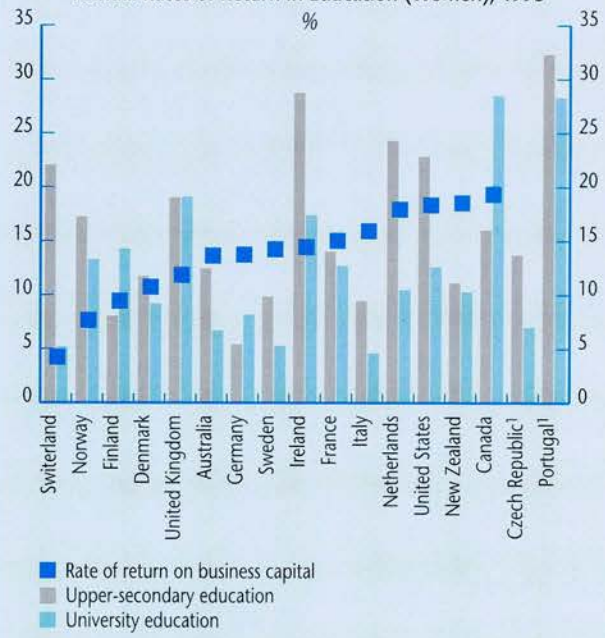
■ ■

Knowing more about how investments of time and money in human capital yield social and economic benefits is becoming increasingly important. Discovering what types of investment in human-capital give the biggest returns is also a pressing concern. It is important to situate investment in human capital in a broad institutional and social context. Moreover, the inter-relationships between human and social capital[4] has to be better understood and measured.

Quantifying information about human-capital investment is very difficult: many of the benefits go beyond additional employment or earnings for individuals and bring unmeasurable returns in the form of social cohesion. To date, of course, the measurement of human capital has been strongly conditioned by what is technically possible, focusing analysis on the benefits of initial educational attainment to individuals, rather than on the more complex relationships between life-time development of skills and the multiple advantages they confer to individuals and to society.

Priority now has to be given to the development of more direct measures of different types of skills and the role of learning in the workplace, as well as the measurement of the social and economic impact of human-capital investment in sustaining development and reducing inequality. ■

Figure 2
Annual Rates of Return in Education (Women), 1995



1. Rate of return on business capital not available.
Source: OECD, 1998

Table
Average Duration of Job-related Training Undertaken by Employed Adults Aged 25–64, 1994–95

	Average duration per person trained (hours)	Average duration per person employed (hours)	Participation Rate (%)
Australia	115.9	48.9	38.1
Belgium/Flanders	126.2	25.2	20.0
Canada	119.8	44.9	37.5
Ireland	218.7	51.2	23.4
Netherlands	159.0	51.7	32.5
New Zealand	154.1	72.2	46.9
Poland	143.2	23.6	16.5
Switzerland	114.1	36.2	31.7
United Kingdom	99.5	51.6	51.9
United States	98.1	44.6	45.6
Average of above 10 countries (unweighted)	134.9	46.9	34.4

Sources: Human Resource Development Canada, Statistics Canada, OECD

4. Social capital is understood as to arise from norms and behaviour based on trust, social participation and information-sharing networks. It helps influence human capital formation (see James S. Coleman, Foundations of Social Theory, *Harvard University Press, Cambridge, Massechusetts, 1990).*

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Putting Social Policy to Work

Libbie Buchele and Peter Scherer

Ministers responsible for health and social policies will meet at the OECD on 23 and 24 June. They will discuss, among other things, the balance between 'passive' cash assistance in the form of government transfers and 'active' measures which combine income support with re-integration into society.[1]

Many social-policy measures have simple objectives. One prominent aim is to protect the vulnerable. This goal is met through 'last-resort' assistance for the destitute, special health-care benefits for the poor and elderly, support for the severely handicapped and social services for children at risk. These policies require little justification: they aim to protect basic human dignity. Another objective is to ensure that people have access to a minimum standard of living, to which end most OECD countries provide universal basic pensions for the elderly and universal health-care coverage.

But social programmes that are not universal and that are confined instead to 'last-resort' protection risk stigmatising the people who receive assistance. They can also lead to poverty traps: when assistance is targeted only at the destitute, those who make an effort to help themselves may be become ineligible for support. As a result, they can be worse off trying to improve their situation than if they remain reliant on income support.

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Most OECD countries therefore regard such 'last-resort' assistance as an unsatisfactory basis for social protection. Instead, they supplement these programmes by using the principles of 'social insurance', whereby entitlement to benefits is 'earned' as individuals build up an employment or contribution record, with cash entitlements usually being proportional to previous earnings (at least until a ceiling is reached). They thus constitute a deferred benefit from employment. Although such payments alleviate poverty, their principal purpose is to insure people against sudden, unexpected changes in their living standards.

The paradox of a system of social protection constructed in this manner is that, if the amount of benefits payable becomes large, it can threaten the very employment on which it is based. Since people who had high earnings – and whose contributions were thus more substantial – receive higher benefits, the taxes to finance them have to be high as well. And where minimum wages or collective agreements prevent wages from adjusting downwards, the effect can be to price would-be workers with low potential earnings out of the labour market because the total cost of their labour – wages plus the social-insurance premiums – are higher than the value of their services to employers.

Unemployment-insurance benefits have most of these features. Since these benefits are intended to provide protection against a temporary loss of income, they generally expire after a prescribed period. High benefits mean that people can spend a long time looking for a job, but the longer they are unsuccessful, the less likely they are to be offered a job by potential employers – and so the benefit can itself contribute to prolonged unemployment. In recognition of this problem, active labour-market policies, designed to aid the unemployed to find a new job, have been advocated for some years as a preferable policy tool to 'passive' unemployment benefits.

Yet over the past decade the main growth in the number of transfer recipients has not been among those receiving unemployment benefits. With the perception, particularly among the long-term jobless, that looking for a position may well be a pointless task, many people have drifted towards other forms of benefit, not least those intended for people who are not expected to look for work: invalidity and early-retirement benefits and benefits for single mothers.

This trend distorts a principle that lies behind the initial design of social insurance, which was intended to encourage participation in employment: since eligibility for benefits is conditional on having an employment or contribution record, they offer an additional incentive to find and take a job. In the Nordic countries, for example, comprehensive social-insurance benefits have been associated with high rates of participation in the labour force, particularly by women. But even there the same drift has been observed: a growing reliance on transfers intended for people who are not expected to look for work.

A Shift in Emphasis

In order to reverse this distortion, there has been a shift in emphasis. From being employment-based, social-benefit administration has started to become employment-oriented. An employment-based system starts from an employment record, and awards rights on the basis of that record. An employment-oriented system, however, promotes employment opportunities –

particularly for those who would otherwise be dependent on benefits.

Employment orientation has profound consequences. The welfare state was intended to protect people who were unable to work from the necessity of having to find a job. But employment-oriented social policies move the emphasis away from such protection, and towards an 'active' stance similar to that attached to active labour-market policies.[2] In practical terms, the shift can be observed in five main categories of benefit: those for health care, for sickness and invalidity, for young school-leavers, for parents looking after children and those which, up until now, have helped finance early retirement.

Health

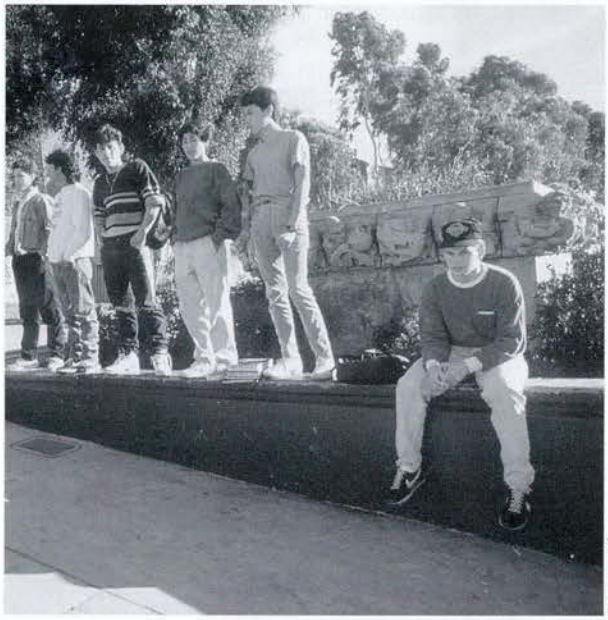
Most OECD countries provide universal health care to all residents,[3] who receive the same privileges whether they are employed or not. In the United States, on the other hand, public health-care provision is confined to the elderly and to those entitled to 'last-resort' income-support benefits. Moving from welfare to work can thus mean losing health cover. In many US states, this problem is now being addressed through 'employment-oriented' health-care policies, which allow people moving from welfare to work to keep their health-care entitlements for a specified period of time.

Other OECD countries often provide public supplementary health cover, such as pharmaceutical, dental and optical care, to those with the lowest incomes. Its potential withdrawal may similarly deter some people from moving into paid employment. Therefore, some countries, such as Australia, are alleviating the problem by maintaining them for a given period after a person finds a job. But this practice is not widespread, and many countries are nonetheless tightening access to these entitlements.

Sickness and invalidity

Sickness and invalidity benefits are being reformed to operate in a more 'active', employment-oriented manner. One means to this end has been to get employers more directly involved in financing and administration: instead of paying premiums to government and leaving the payment of benefits to a social-insurance agency, employers in the Netherlands, Sweden and the United Kingdom have been made responsible for paying initial amounts themselves.

The other element has been a series of reviews arising from a paradox in the way eligibility is determined. Invalidity benefits (in particular) are intended for people who cannot work, but in recent years the possibility of finding work began to be used as a criterion for determining invalidity status, undermining the assumption that those in receipt of invalidity entitlements are indeed 'incapacitated' and therefore cannot be expected to find paid employment. Countries where this had occurred – including Australia, Canada, Italy, the Netherlands, Norway, Portugal and the United Kingdom – are now trying to reverse the process, and once again to confine invalidity benefits to those who are unable to work.



Serge Attal

Some countries now make social insurance for school-leavers conditional on training or other employment-related activity.

Young school-leavers

Young people leaving school do not have a record of employment and therefore are not usually eligible for social-insurance coverage. Many OECD countries nonetheless offer support while they look for work. But the terms for receipt of such assistance have been tightened considerably in recent years, and there are now very strict requirements in countries such as Denmark and the United Kingdom that make income support available to only some young people – and for them it is conditional on participation in direct, employment-related activity or training.

Parents looking after children

In the Nordic countries, with the sole exception of Norway, assistance for single mothers who are in need is awarded on the basis that they are expected to seek paid employment and accept it if offered. This position reflects a long-standing commitment to an employment-oriented social policy, whereby most barriers to employment for single women (lack of child care, for example) are removed, enabling them to enter the work force.

In many other countries, by contrast, single mothers have been eligible for income support on the basis that they are taking care of children and therefore saving the community the cost of providing child-care. But this arrangement can lead to long-term dependency. Therefore, most countries which grant such benefits have now, like the Nordic countries, moved to encouraging or requiring single mothers with school-age children – and, if suitable child-care is available, pre-school children – to seek work or engage in employment-related activities if they are to continue to receive income support. Simultaneously, the period during which support can be received is being reduced.

1. ***Dignity and Social Solidarity***, *OECD Publications, Paris, forthcoming 1998.*

2. *Peter Schwanse, 'Activating the Unemployed',* ***The OECD Observer****, No. 209, December 1997/January 1998.*

3. *Recent immigrants often find themselves without coverage, leaving them exposed to considerable risk.*

Putting Social Policy to Work

The context in which these requirements are enforced is related to the conditions of employment of married women. In European countries with comprehensive social-insurance systems, married women in employment are likely to be entitled to paid maternity leave, and to have access to publicly provided or funded child-care. Single mothers who are required to look for work will generally be offered the same facilities.

But where employment conditions are less regulated, married women who work may have few, if any, of these sorts of assistance provided by their employer. In these circumstances, single mothers are likely to be required to fend for themselves in child-care, and coping with other problems in reconciling work and maternal responsibilities. And with no partner to help shoulder the burden, they can experience considerable hardship. 'Work, not welfare' policies which encourage, or push, women back into the labour market are unlikely to succeed unless child-care and parental leave are available. But the provision of such facilities by the state will be seen as inequitable unless they are also made available to married women.

Indeed, there are some indications that in certain countries, care provided at home is becoming more, not less, popular, particularly as the ageing population places pressures on state-sponsored care programmes. Care provided by the family is less costly to the public purse than care provided by outside agencies. As a result, in some countries (including Australia, Austria and the United Kingdom) those responsible for care of invalids or frail or elderly people have been recognised as entitled to public support and, where an employment record is necessary for pension entitlements, are sometimes credited with employment. Care of children has been given similar recognition (though less widely so and usually in particular circumstances), and sometimes married women who care for children in their home receive an allowance on this basis (for example, in Finland and France). As indicated above, however, the drawback with such policies is that they run the risk of isolating the women who receive support for such care, as they find it difficult to enter the labour market later.

Early retirement

The marked trend to earlier retirement, a feature of many national labour markets over the last decade,[4] is a combination of active choice by people with the resources to do so and forced 'choice' by those faced with the option of either early retirement or long-term unemployment. Simple exhortation by worried governments will not turn the tide. An attempt to reduce immediate pension rights of those about to enter retirement will be resisted as inequitable. Analysis undertaken at the OECD recently argues strongly that existing incentives have played a considerable role in the trend to early retirement. The goal of pensions reform must be to rebalance incentives for both employers and workers in ways which favour continued employment.

The encouragement to early retirement which has been provided by public pension rules has started to be withdrawn: early access to pensions is being reduced, as is their generosity. Increases in the length of employment required to earn a full pension (for example, in France and Italy), combined with bonuses for continuing working in many countries, including Australia, Canada, Luxembourg and Sweden, are improving incentives to stay on at work. But it will be a long time before these changes have gone far enough to reverse the trend to early retirement.

■ ■

In all OECD countries, social policies smooth out the inequalities in the market economy, both through the operation of the tax and transfer system and through the direct provision of health and education services. And the multiple goals of policy are as important here as anywhere else. Transfer programmes which are not employment-oriented are likely to be self-defeating: they risk being perceived as inequitable by those who finance them and being resented as providing an inadequate and exclusionary form of support by recipients who cannot find a job.

Social policy, therefore, has to be able to deal with the interaction between cause and effect. Some people, for example, become socially excluded because they lose their job; others are unemployed because they are socially excluded. A well-designed employment-oriented social policy will both seek to re-integrate people into the job market and supplement low incomes in employment, thus reducing inequality without creating dependency. It will also facilitate learning and re-training, in order to help individuals move up the career ladder from low-paid jobs.

But implementing an effective employment-oriented social policy implies some hard choices. Social insurance which emphasises income maintenance often does not protect the vulnerable who have no income to maintain. It is now clear that genuine protection of the vulnerable requires employment-oriented, active policies. But these are more expensive than simply providing minimal cash assistance, and all OECD governments operate under tight budgetary constraints. Hence 'work, not welfare' is not in itself a sufficient basis for successful employment-oriented policies. Resources will have to be found elsewhere – and an obvious source in the social-protection budget is a reduction in public income-maintenance provisions for people in well-paid employment. ■

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4. *See pp. 15–19.*

The Rise of the Institutional Investor

Hans J. Blommestein and Norbert Funke

Institutional investors have enormous financial clout in the world's financial markets, and their importance is growing. The impact of their investment strategies and trading techniques can be felt across the globe, both in financial markets and the business sector generally. And the mounting sophistication of their investment and trading activities evokes a number of regulatory and supervisory issues, such as the rationale of investment restrictions, the role of risk-management standards and systems, and the adequacy of the financial infrastructure in both OECD and emerging market economies.[1]

Institutional investors – insurance companies, investment companies and pension funds[2] – have been gaining in importance in both OECD and non-OECD countries. In 1995 the total assets of such institutions in the main regions in the OECD area amounted to more than $24.4 trillion (an astonishing 106.7% of GDP). And between 1990 and 1995 the average annual growth of holdings by institutional investors reached 10.5%, although this amount varied markedly between OECD regions (Figure, p. 39).

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There is thus a fundamental change in financial structure: savings are being shifted away from regulated and insured banking institutions to entities that are sometimes not insured, and that operate in different regulatory regimes and have different investment objectives. This rising institutionalisation of savings has a profound impact on the structure and functioning of the world's capital markets.

A strong community of institutional investors has a number of beneficial effects. For example, countries with an important institutional sector – Canada, the United Kingdom and the United States, for example – tend to have highly developed securities markets. The evolution of sophisticated trading arrangements and the introduction of new instruments constitute a response to their requirements, and the ongoing expansion of the institutional sector is likely to stimulate further financial innovation. The institutionalisation of savings has also led to an increased supply of long-term funds, part of it in the form of an improvement in the supply of risk capital, stimulating new businesses and helping create jobs.

Several new issues for policy arise alongside these welcome side-effects. Policy-makers will have to scrutinise closely the functioning and regulation of institutional investors, since they have a growing influence on the structure and *modus operandi* of financial markets. They must also be aware of the role and importance of these markets for the real economy, corporate finance, corporate governance and retirement income security.

Investment Strategies and Portfolio Composition

Institutional investors increasingly rely on complicated investment strategies and techniques. The growing influence of the professional fund-management industry is combining with

1. ***Institutional Investors in the New Financial Landscape***, *OECD Publications, Paris, forthcoming 1998.*

2. *Institutional investors are usually defined as financial institutions that 'invest' savings of individuals and non-financial companies in the financial markets. This definition is not very precise, and in dynamic financial markets it becomes increasingly elusive. The key is that the definition indicates that funds are being professionally or institutionally managed, as distinct from money managed by retail investors for their own account. Examples of institutional investors that are generally found in all OECD countries are pension funds, insurance companies, open-end funds, hedge funds, closed-end funds and the proprietary trading activities of investment banks, commercial banks and securities companies. The shifting of the capital market from dominance by retail investors to financial institutions is often referred to as the 'institutionalisation' of capital markets. For a detailed analysis of pension funds, see pp. 23–27.*

The Rise of the Institutional Investor

BACKGROUND

Whence the Institutional Investor?

Several common factors have been crucial in driving the growth of institutional investors as a group. Four are particularly important.

First, the ageing of the populations of the OECD area has produced a rising demand for retirement 'products' such as mutual-fund products, equity-indexed annuities, asset-backed securities and guaranteed-equity plans by increasingly well-off and sophisticated individual investors. Simultaneously, the baby-boom cohort of the 1940s and '50s is causing looming fiscal problems in countries relying predominantly on pension systems financed by 'pay-as-you-go' contributions made through the state. This has stimulated the introduction of advance-funded pension schemes.

Second, technological progress in communications and information processing has enhanced the capacity of the financial-services industry to provide intermediation and risk-management services by handling vast flows of information at very high speed and at very low costs. This trend is giving rise to a new breed of sophisticated investment products (money-market mutual funds, swaps, options and credit derivatives, for example) – a process supported by methodological break-throughs in the pricing of sophisticated financial instruments. The innovation and creativity characteristic of the US capital market has had a powerful impact on financial services in the world as a whole.

The third influence has been the deregulation of the banking and securities industries since the beginning of the 1980s, which has heightened competition between and among banks and other financial institutions. At the same time, the abolition of restrictions on cross-border capital flows and on the entry of foreign financial institutions has further increased competition in the OECD area. These forces, together with the introduction of international capital standards for banks, have almost everywhere caused a massive move by banks into the fee and commission business associated with capital-market transactions, thereby further blurring demarcation lines between banks, insurance and fund-management.

Fourth, disintermediation from banks through reduced demand for bank deposits and traditional savings vehicles has resulted in a shift in favour of more performance-oriented instruments like money-market funds and mutual funds investing in equity. This process is particularly noticeable in the North American capital market, where the percentage share of bank deposits in total financial assets of the personal sector has fallen from 26% in 1976 to around 15% in 1996. But there is evidence of this trend also in other countries; for example, in France, cash and deposits as a percentage of total household assets fell from around 65% in 1976 to around 34% in 1996; and in Germany from 62% to 43%.

Apart from these broad trends, a number of other factors are important, such as special tax-treatment of retirement savings, the rate of return on institutional savings products offered (relative to those obtainable from other financial products), the regulatory and supervisory infrastructure (and changes in it), as well as existing attitudes to the various means of savings – for example, the differences in countries with an 'equity culture' (mainly English-speaking countries) versus those with a 'banking culture' (mainly continental Europe and Japan). In addition, many countries have policies that explicitly promote particular types of institutional investors, private pension schemes chief among them.

technological progress in communications and information processing supported by important methodological break-throughs in the pricing of sophisticated financial instruments. Of course, the actual strategies being followed by institutional investors – and the resulting portfolio composition – may differ considerably. That is because the nature of their liabilities and their fiduciary mandates differ and, therefore, also their investment objectives. Some are strongly risk-averse; others can invest in riskier projects with higher expected returns. Some funds are actively managed; others use passive investment strategies based on indexation techniques. Funds may be managed in-house or externally, or both; a common feature is that institutional investors increasingly use professionals to manage the portfolios. The fund-management profession is therefore a central factor in analysing the relationship between institutional investors and financial markets (box, left).

The composition of the portfolios of institutional investment shows two strikingly different patterns. First, holdings of equities are fairly limited in most OECD countries, although there are exceptions (the United Kingdom and the United States, for example) and the share of equities is increasing in most countries. Second, there is a considerable domestic bias in asset allocation which, partly because of regulation, tends to be stronger for pension funds and life-insurance companies than for mutual funds (Table, right).

Investors will want to know whether a 'passive' or an 'active' management strategy is more suitable. There is a large body of evidence that shows that for most fund-managers it is difficult consistently to out-perform or beat their benchmark performance indexes. Nevertheless, many institutional investors are still willing to pay for active management – and the more an institution believes that the skills of a portfolio manager are worth paying for, the more the manager will be allowed to deviate from the benchmark index. In fact, many pension funds follow a hybrid strategy, where the fund maintains a passive core, which is an indexed position, and augments that position with actively managed portfolios. Indexing remains a low-cost way to

create diversification for an entire pension fund or as part of a mixed active/passive investment strategy.

It is very common simply to measure the performance of a portfolio manager against an established benchmark. But the trend is to supplement this measure with an indication of the amount of risk that a portfolio manager has taken to achieve his return. Some US institutions have 'custom benchmarks' which are tailored to their own structure of liabilities and which include their own tolerance for volatility.

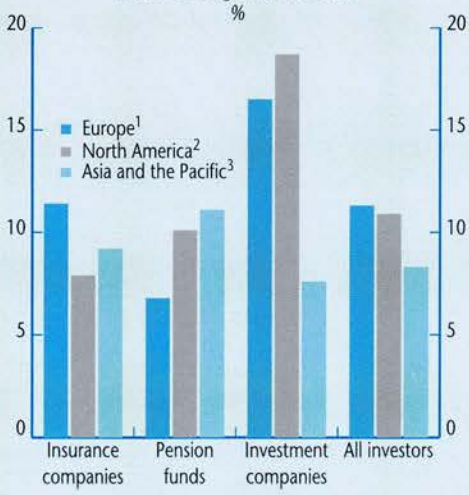
The Impact on the Financial Landscape

A range of forces is shaping the global financial landscape: demographics and pension reform, technology and communication advances, disintermediation, deregulation, improvements in the financial infrastructure in an increasing number of emerging markets. These factors may lead to continued substantial adjustments in portfolios in the form of a switch into financial assets, an increase in equity holdings and other forms of risk capital such as venture capital, as well as more cross-border investments. Among the major immediate challenges with which investment managers will have to cope are the planned introduction of a single currency in Europe, and the associated development of new market sectors (for example, for lesser-rated debt and instruments such as asset-backed securities, which have hitherto reached only modest proportions in Europe).

The introduction of the euro will probably increase the liquidity of European capital markets, thereby decreasing transaction costs and facilitating the (re-)allocation of institutional assets and the management of risks. Currency-based investment restrictions will become almost meaningless and the home bias may weaken. And as it will be less possible to 'play' currencies, diversification strategies based on investment in different sectors and on investments outside Europe and in higher-yielding but riskier projects may become more important. The remaining distortions in the European Union will become more visible, and pressures for removing them will increase.

Population ageing may bring a decline in the prime savers' ratio[3] in around ten years' time, which could lead to major adjustments in the portfolio of institutional investors. This may put downward pressure on the prices of financial assets. This prospect, which is attended by considerable uncertainty, is based on the consideration that the accumulation of financial assets by institutional investors could slow down because of demographic developments, which

Figure
Average Annual Growth Rate of Institutional Investors in OECD Regions, 1990–95
%



1. Excluding Iceland and Ireland.
2. Canada, Mexico, United States.
3. Australia, Japan, Korea.
Source: OECD

3. The prime savers' ratio is defined here as the ratio of savers in the age range 40–60 years to those in the range 15–60.

Table
Institutional Investors' Holdings of Securities Issued by Non-residents, 1987–96
% of total assets

	1987	1990	1992	1994	1995	1996
Pension funds						
Belgium	34.1	30.0	29.2	33.0	35.8	35.4
Canada	..	7.0	11.0	14.0	14.0	..
France	..	..	2.0	5.0	4.4	..
Germany	..	4.5	4.3	7.0	5.3	7.7
Italy	..	..	4.0	5.0	..	..
Japan	14.3	16.0	14.4	10.8	12.5	14.9
Netherlands	12.8	15.8	17.1	22.0	21.0	30.2
Sweden	..	..	..	11.0	9.1	14.8
Switzerland	4.0	4.2	6.0	13.0	16.0	18.6
United Kingdom	14.0	20.0	24.0	27.0	26.8	29.2
United States	2.5	3.5	4.3	8.1	9.1	10.4
Life-insurance companies						
Belgium	3.1	3.7	3.1	6.3	7.2	..
Canada	..	1.1	0.7	0.5	0.3	..
France	..	..	..	..	..	..
Germany	..	1.0	..	..	4.0	..
Italy	..	..	..	..	..	..
Japan	..	13.5	11.4	6.7	6.9	..
Netherlands	4.6	3.9	5.3	7.8	..	..
Sweden	1.5	5.4	7.8	10.4	12.7	..
Switzerland	..	..	..	..	..	..
United Kingdom	8.8	10.7	12.4	13.5	14.2	..
United States[1]	3.0	3.6	3.7	5.4	5.9	5.8
Mutual funds						
Belgium	40.2	42.1	35.7	43.1	38.9	..
Canada	..	17.5	17.0	23.6	23.4	..
France	..	..	..	..	..	..
Germany	25.2	35.4	29.6	23.0	20.2	..
Italy	9.2	11.2	22.4	28.1	24.0	..
Japan	..	7.9	9.9	..	..	..
Netherlands	..	..	..	..	..	..
Sweden	..	5.4	12.4	15.7	16.8	..
Switzerland	57.6	60.3	65.3	69.5	65.5	67.2
United Kingdom	26.7	31.0	35.2	36.4	34.5	..
United States	..	6.6	10.1	..	..	..

.. not available
1. Foreign bonds only.
Sources: Pragma Consulting and OECD

Managing Assets around the World

The degree of institutionalisation differs markedly across countries and regions, and the importance of the three basic types of institutional investors – insurance companies, investment companies and pension funds – also varies substantially (Table).

North America

In the retirement sector in the United States the move from defined-benefit retirement plans to defined-contributions plans has played an important role in generating demand for new financial products, changing allocation strategies, and increasing demand for asset-management services. Defined-contribution plans have grown impressively, covering an estimated 83% of companies with 500–1,000 employees by the end of 1996. This shift implies a change in investment risk-bearing from corporate sponsors to the individuals who participate in the plans. It means also that the availability of suitable investment choices for individuals becomes more important than ever.

In Canada, investors are increasingly willing to shift from bank deposits and investment products with guaranteed returns to fluctuating instruments and money-market mutual funds. In addition, a shift from defined employer pensions to private savings is occurring. This 'retailisation' of savings implies that, although money is becoming more institutionalised, it is at the same time more readily accessible and freer-flowing than before. Simultaneously, international portfolio diversification is increasing.

One similarity between US and Canadian asset-managers is their emphasis on equity investment. Asset-managers in most other countries – with the exception of the United Kingdom and Australia – traditionally focus more on fixed-income markets. Rough comparisons between the European and the US markets show a '3/3' rule for European markets, with a third each of total assets going into money market, bonds and equities; in the United States the relationship is half equities and the other half roughly equally divided between money market and bonds.

Table
Assets of Institutional Investors, 1990 and 1995
% of GDP

	1990			1995		
	Insurance companies	Investment companies	Pension funds	Insurance companies	Investment companies	Pension funds
Australia	30.4	9.8	17.6	38.2	12.4	31.4
Austria	16.8	9.0	0.5	22.2	14.2	1.0
Belgium	29.7	13.0[a]	3.2[b]	31.2	22.9[a]	4.0[b]
Canada	25.9	5.3	30.0	30.8	19.1	41.0
Czech Republic	–	–	–	5.2	2.4	–
Denmark	41.0	2.8	16.1	46.6	3.7	18.7
Finland	7.4	0.1[a]	26.6[c]	12.3	0.9[a]	36.4[c]
France	20.0[a]	32.9[a]	3.4	37.9[a]	37.6[a]	4.3
Germany	26.0	9.0	3.3	29.5	16.4	2.9
Greece	2.9	..	6.5[a]	3.1	9.6[a]	10.9[a]
Hungary	2.8	–	–	3.2	1.1	0.1
Italy	10.7	3.8	5.2	16.7	7.4	5.9
Japan	35.4	13.1[a]	11.5	37.5	9.7[a]	11.3
Korea[a]	18.9	26.1	3.1	23.4	31.2	3.1
Luxembourg	..	909.2	19.7	44.9	2,076.4	19.6
Mexico	1.9	8.0	–	2.2	2.7	–
Netherlands[a]	41.1	11.3	81.0	*52.2*	*17.1*	*88.2*
Norway	31.0	2.3	4.6	33.1	4.9	6.6
Poland	–	–	–	1.4	0.2[a]	–
Portugal	4.4	4.4	1.8	6.8	16.4	9.1
Spain	11.3[d]	3.2	2.9	19.0	18.3	2.1
Sweden	41.0	16.9[a]	34.2[e]	55.9	22.2	40.1[e]
Switzerland	58.7	11.1	72.7	59.5	16.9	73.2
Turkey	0.6	0.4	–	0.8	0.3	–
United Kingdom	54.3	13.1	60.5	77.1	21.8	71.7
United States	35.4	20.8	46.1	41.5	38.8	59.5

.. not available
– nil or negligible
Figures in *italics* are provisional
a. Financial assets.
b. Including financial assets of saving pension funds for 1990 and 1995 of 1.1% and 1.5% respectively.
c. Financial assets of occupational pension schemes.
d. Including insurance companies and autonomous pension funds.
e. Including pension funds within the social-security sector for 1990 and 1995 of 32.5% and 37.7% respectively.
Source: OECD

Asia

In Japan, savings were traditionally held in deposit accounts and insurance contracts, with relatively small amounts held in other institutional forms, although the demand for higher-yielding investment products is growing steadily. The institutional-fund market is segmented into several sectors, each of which used to be highly regulated. The investments that were permissible were either high-quality, domestic, fixed-income securities or constrained by fairly specific rules on portfolio allocation. A number of the institutions pursued what were basically 'buy and hold strategies'. The modernisation of the Japanese institutional sector – and the associated reforms of the financial sector – are gathering speed. Nonetheless, the market still shows important structural deficiencies, chief among them lack of competition in fund-management, lack of professionalism among domestic fund-managers, and a scarcity of suitable domestic investment products.

Japanese institutional investors are currently facing a number of particular difficulties. With inflation low and yields lower yet, they have to take on additional risk to improve their returns. Big

investors facing stringent criteria for investment would generally prefer to undertake limited foreign-exchange risk instead of additional credit risk because of higher expected returns without increasing imprudently their desired risk-profile. The situation is expected to improve after the implementation of the Japanese 'big bang' deregulation measures, starting in April 1998, which are expected to heighten competition in the financial sector and broaden investment opportunities.

In Korea, the activities of institutional investors have gradually been deregulated since the mid-1980s, and they now play an important role in the Korean securities market. At the end of 1996, banks, securities companies and other such investors owned 31% of all the shares listed on the Korean stock exchange. This rising profile, coupled with the dramatic effects of the recent financial crisis, will bring fundamental changes to Korean financial markets. In Asia as a whole, indeed, the fall-out from the 1997 financial crises is expected to speed-up the modernisation of financial markets, which would further benefit the expansion and efficiency of the institutional sector.

Europe

Developments in continental Europe show quite clearly that, with exceptions such as the Dutch pension-fund industry and the French investment-fund market, institutional investors are less important than in the English-speaking countries. In Germany, for example, the dominance of the bank-based system and of state-funded pensions (operated on a pay-as-you-go basis) combine with the lack of an equity culture to restrict institutional investors to a very modest role.[1] In making private provision for old age, German companies generally use book reserves to finance occupational pension schemes.

In Belgium, too, institutional investors (in particular pension funds) have a relatively low profile. Investment funds nonetheless reach the second-highest rate of penetration in the European Union, after France. Guaranteed equity plans constitute the fastest-growing sector, perhaps because Belgium has one of the oldest populations in the world (21% over 60 years old), and investors tend to become more risk-averse as retirement approaches. In addition, products with guaranteed returns may be particularly attractive for newcomers to the equity market and during periods of high market volatility.

An analysis of the world investment-fund market shows that the United States holds the lion's share, with a 57% market share at the end of 1996. Although the average fund size is approximately five times as large as in Europe, Europe takes a strong lead in terms of the number of investment funds. The proportion of equity funds has not increased substantially in major European countries, probably reflecting the lack of a strong equity culture in these countries. How funds are invested varies considerably between economies: countries such as France, Greece, Italy, Portugal and Spain invest predominantly in the domestic and fixed-income sectors, while the Netherlands, Switzerland and the United Kingdom show a high proportion of international and equity assets.

Emerging Markets

The expanding role of institutional investors in emerging markets can help promote capital-market developments there. They may also have a positive impact on the more efficient mobilisation of domestic savings and thus encourage the supply of productive capital (although the relationship between institutional investors and the general volume of savings has evaded precise analysis). The depth of Chile's capital market, for example, is often attributed to its pension-fund system and, after success in Chile, privatisation of pension systems has started to gain momentum in Latin America in the 1990s. In the life-insurance sector, nonetheless, emerging countries continue to play a less important role, with a world market share of net premium income of less than 10%.

1. Jørgen Elmeskov, 'Germany: The Structures of Corporate Governance', **The OECD Observer**, No. 196, October/November 1995.

would in turn have an influence on the rates of return on various types of assets.

Because asset preferences vary across age-groups, the ageing of the baby-boom generation could affect both absolute and relative stock and bond prices.[4]

Clearly, these population-induced influences on financial-market prices could adversely affect the financial performance of pension funds in the coming decades. Yet many non-OECD countries have younger populations, opening-up the possibility of benefiting from the fact that they are several decades behind the OECD countries. When the number of retirees rises in OECD countries, the emerging markets will have a large share of their populations in the 'prime saver' category. Fund performance may therefore be improved by increased diversification into younger, emerging-market economies.

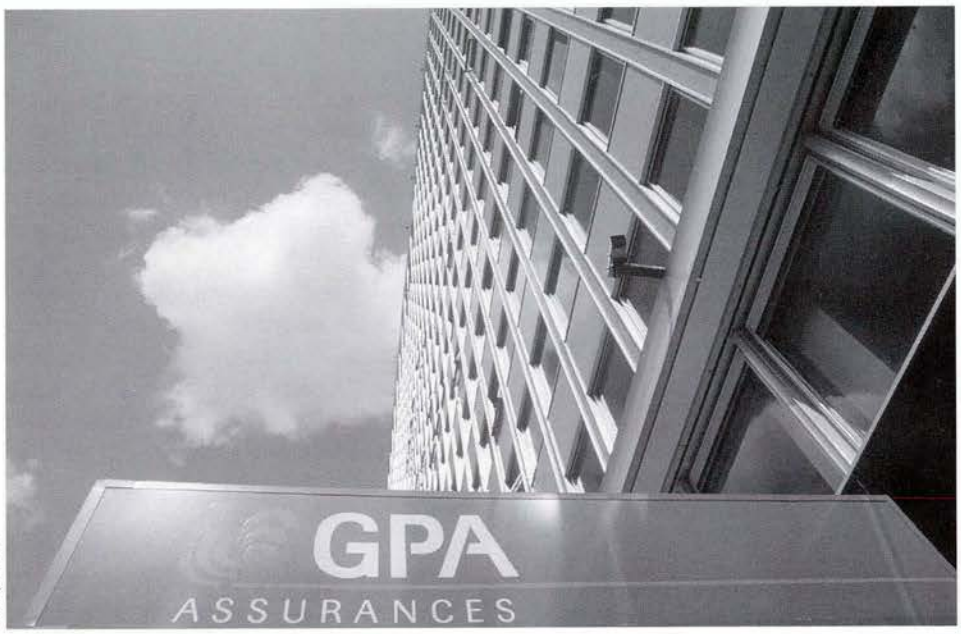
Nonetheless, although asset-diversification by OECD institutional investors in non-OECD economies is potentially a sensible strategy, empirical evidence shows that the beneficial effects are modest. Moreover, if pension funds move toward more international diversification of their holdings, demographic influences similar to those working on domestic stocks and bonds could be felt in international stock and bond markets and in foreign-exchange markets. Although the net effects of diversification arising from investment by the ageing OECD economies in the younger, non-OECD countries can be expected to remain beneficial, it seems highly unlikely that they are high enough to rely upon to avoid or solve fully the basic pension problems of the OECD countries.[5]

Regulation and Supervision

The regulation of the activities of institutional investors differs both across types of investors and across countries. The regulation of pension funds, for example, varies markedly across OECD countries. A number of them (Denmark,

4. For more details, see p. 25.
5. See pp. 7–14.

The Rise of the Institutional Investor



Aurel/Jerrican

Restrictions on where insurance companies may invest are up for reconsideration.

Germany and Japan, for example) impose quantitative regulation on portfolio investments, whereas in others, mainly the English-speaking ones and the Netherlands, the 'prudent man' rule is dominant.[6] There is some evidence that portfolios regulated by quantitative restrictions obtain lower returns than those that apply the 'prudent man' concept. Exposure to risk is influenced by how funds are allocated, that is, how well assets are diversified. Internal funding, too, tends to be more risky than external. For example, a particular feature of German private pensions is that pension liabilities are held directly on the balance sheet of the sponsoring firm and are not fully funded. By their nature such book reserves are highly undiversified, and therefore, to be viable, seem to require a compulsory insurance system.

Against the backdrop of the emergence of new financial instruments, growing inter-relationships with other financial institutions and globalisation of the insurance market, many OECD countries are considering changes in the regulation of investment by insurance companies. Meanwhile, there are limits in most countries on the particular types of investment in which life-insurance companies can put their money. Although in many cases the maximum permitted in these categories of assets has been set relatively high, in a number of countries this limit may have inhibited investment choice in individual cases.

The recent recurrence of unexpected losses made by institutional investors suggests that many of the conventional risk controls (for instance, investment only in high-grade securities, restriction of average maturity, currency risk, guidelines on hedging, and so on) may be unsatisfactory. Guidelines on systems that measure risk-management and its practice appear to require updating, in particular because financial engineering makes a number of existing ones obsolete or less effective.

A central issue for policy is the extent to which the development of risk-management standards for the institutional sector can be linked to a relaxation of quantitative constraints on the allocation of assets. It has been argued, for example, that the adoption of an up-dated framework of risk-management in the insurance sector would deal more effectively with two key risks faced by life-insurance companies: interest-rate risk (in conventional life-insurance and annuity contracts) and inflation risk (in long-term savings vehicles, chiefly for retirement purposes). Similar arguments are valid for the pension-fund industry: consideration should be given to the introduction of a supervisory framework based on prudent-man principles combined with sound risk-management standards, rather than an approach based on quantitative restrictions on asset allocations.

■ ■

Institutional investors will continue to grow in importance. It is increasingly recognised that, with ageing populations, 'pay-as-you-go' pension systems financed by the state will bring considerable budgetary difficulties. In response, many OECD governments are taking steps to reform the retirement system by introducing advance-funded pension schemes. This will bring substantial volumes of savings under the control of funded pension systems. The rising public awareness that maintaining continued growth in living standards during longer periods of retirement will require additional savings is likewise stimulating the demand for retirement products from life-insurance companies and investment funds.

The growth of the institutional investor is encouraging reform of the financial sector by a further strengthening of the infrastructure of capital markets – which would enhance in turn a further growth of the institutional sector. And since the driving forces of the growth of the institutional sector are similar in most countries, it is not only the size and structure of the institutional sector that may converge but also the structure of OECD financial markets themselves. ■

6. The precise meaning of the 'prudent man' concept differs somewhat from country to country and may change over time. In general, this principle requires managers to follow high fiduciary standards in investing funds. It allows fund managers to set their own investment guidelines and avoids the pitfalls of government interference with market processes.

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Spotlight

New Zealand

Reform of the Financial Sector

Hannes Suppanz

The development of the financial sector in New Zealand illustrates the contribution major structural reforms can make to improving economic performance.[1] Up to the mid-1980s, New Zealand's approach to regulating financial markets – and indeed most sectors of the economy – was largely protective. In micro-economic terms, the regulatory regime was extensive: various financial institutions were covered by different sets of regulations, with limited scope for firms to operate in more than one type of business; there were restrictions on entry, especially into banking, and limits on the extent of foreign ownership; and direct controls affected many aspects of financial-market activity, with ceilings on deposit and lending rates, restrictions on assets and liabilities, controls on various kinds of lending, as well as limits on external capital flows. The macro-economic legal framework embodied multiple, often conflicting, objectives governing monetary policy, the implementation of which relied directly on these wide-ranging regulatory controls (reserve ratio requirements for all major financial institutions and interest-rate controls, for example), together with a regime of managed exchange rates.

The programme of economic liberalisation that was pursued in New Zealand from 1984 onwards started with one of the most broad-based and rapid reforms of financial policy ever undertaken.[2] The decision to do so was motivated by a number of factors. Steadily worsening macro-economic imbalances culminated in a currency crisis, which partly reflected inefficient and inflexible capital markets that rationed credit and ran at high cost. The large 'informal' sector that developed outside the control of the authorities made monetary policy ineffective and difficult to implement. Government ownership of, or guarantees to, some institutions (including major banks and insurance companies) meant that taxpayers faced considerable risks in the event of failure. And, last but not least, structural change brought about by technological innovation and internationalisation was weakening the effectiveness of protective regulation.

From early on, the goals of financial reform were motivated by the desire to overcome these problems. Three broad objectives can be identified:

- achieving more efficient financial intermediation by putting in place a competitively neutral policy environment that encourages contestability within and across markets
- enhancing the stability and integrity of the financial system to minimise the (potentially large) adverse knock-on effects that an unstable financial sector, or one lacking investor confidence, could have on the rest of the economy
- alleviating macro-economic imbalances by improving New Zealand's performance in inflation and savings in particular.

Two Phases of Reform

There were two distinct phases of financial-sector reform in New Zealand. The first, during the 1980s, focused mainly on opening up the sector to competition. The crucial measures were:

- the abolition of interest controls
- the floating of the New Zealand dollar
- the removal of restrictions on balance-sheet structures (that is, restrictions on assets and liabilities, lending controls and so on)
- the relaxation of entry restrictions to the financial sector
- the removal of limits to foreign ownership of New Zealand companies
- the privatisation of state-owned financial institutions
- the removal of restrictions on borrowing foreign currency.

Garbat/Gamma

During this phase, the main macro-economic focus of the reforms was on monetary policy. As early as 1984, an explicit policy of fully funding the fiscal deficit at market interest rates was adopted, and in subsequent years a number of improvements were made to liquidity management. The reforms culminated in the 1989 Reserve Bank Act, the essential elements of which are a single and explicit objective of price stability, central-bank independence in the implement-

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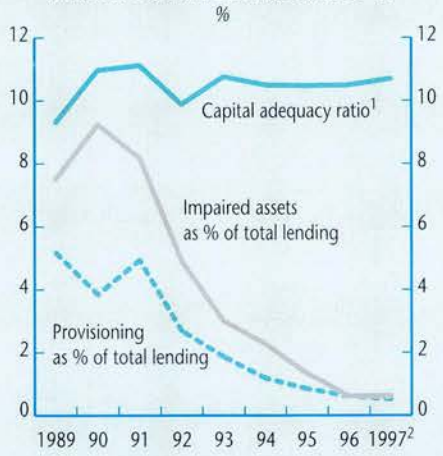
1. ***OECD Economic Surveys: New Zealand***, *OECD Publications, Paris, 1998.*

2. *Paul E. Atkinson, 'New Zealand's Radical Reforms',* ***The OECD Observer****, No. 205, April/May 1997.*

New Zealand
Reform of the Financial Sector

Figure
Indicators of Bank Soundness, 1989–97



1. Non-bank financial institutions only for 1997.
2. September 1997.
Source: Reserve Bank of New Zealand

ation of monetary policy, and an accountability structure that requires regular reporting by the Governor of the Reserve Bank to Parliament.

The second phase of reform, in the 1990s, was more concerned with re-engineering some of the basic legal infrastructure for banking and commerce and overhauling supervision arrangements. Initiatives during this period reflected the inevitable learning process that followed the early stages of reform, as well as the continued structural pressures being exerted on the sector by technological change and internationalisation.

In addition, the rapid expansion of financial-sector activity during the 1980s and the impact of the 1987 stock-market crash encouraged some reflection on how the sector should be regulated, and in the early 1990s the Reserve Bank initiated a review of banking supervision in order to establish to what extent disclosure (providing information by public statements) could be a substitute for, or complement to, more direct forms of surveillance. The motivation for this potential change was three-fold. First, intense competition, new entry and reduced government involvement increased the risk of systemic difficulties. Second, standard approaches to prudential supervision (such as on-site examinations) were felt to have a limited ability to reduce the incidence of bank failure and distress. And, third, they involved considerable compliance costs and encouraged the perception that the government would stand behind an institution facing problems.

In 1996, the review culminated in a major reform that replaced internal controls, and limits on lending and foreign exchange exposures, with a comprehensive regime of public disclosure and requirements on bank directors to attest to the accuracy of the wide range of information to be provided.

Such a market-based approach to banking supervision has prompted a number of observations. In particular, it has been suggested that, since almost all banks in New Zealand are foreign-owned, the system effectively 'free-rides' on the efforts of overseas supervisors – even though the authorities continue to be responsible for monitoring bank activities and have wide powers to intervene when the stability of the financial system is threatened. Other commentators have suggested that it would be unrealistic to expect the vast majority of depositors to read the disclosure statements. In fact, the new system does not rely on alert depositors, but rather assumes that the media, financial analysts, wholesale creditors and banks use the information and disseminate it to a wider audience. Initial trends suggest that this is indeed the case. It also appears that bank directors are now taking an approach to risk-management which looks further ahead, by anticipating market reactions and acting quickly to avoid a worsening situation.

The Fruits of a Radical Approach

It is too early to draw firm conclusions about the success or otherwise of the new regime of banking supervision, although it seems that in most respects the reforms of the financial sector have delivered on their objectives. The financial sector as a whole now appears to be much more efficient. In banking in particular, there is evidence of lower costs and margins and, in recent years, the quality of bank balance-sheets has improved substantially (Figure). Borrowing and lending activity has expanded enormously, as has the range of financial instruments available, and there has been a marked improvement of service and consumer choice. Taxpayers, moreover, are carrying far fewer risks in the form of either implicit or explicit government guarantees in the financial sector.

There have been macro-economic gains as well. The indications are that the quality of investment has improved. And, after some transitional problems, the reforms have allowed monetary policy to focus on, and achieve, low inflation.

A number of lessons emerge from New Zealand's experience of financial-sector liberalisation. Although the reform has proved generally successful, the achievement of its objectives – promoting efficiency and enhancing stability, both in the sector and in macro-economic terms – has taken time. And the path has not always been smooth. For a while, the financial sector went through a 'boom-bust' period. Monetary policy faced, and is still facing, a number of difficulties, some arising from the forces unleashed by reform. And some (probably over-optimistic) expectations have not been fulfilled – in particular, that the reform could enhance the savings performance of the economy.

Moreover, although for the most part the financial sector now seems to work well under existing arrangements, the structural pressures facing it – chiefly, as ever, internationalisation and technological change – mean that further adjustments are likely to be desirable. But such challenges are inherent in the nature of a small, open economy and must be balanced against the benefits of a dynamic and efficient financial system – and the results to date suggest that they are worth meeting. ■

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For the Record

The OECD Economic Outlook

Highlights

Financial- and exchange-market tensions in Asia subsided in the first quarter of this year. However, the situation in the region remains fragile. In the near term, all of the emerging countries affected by the crisis will have to undergo substantial adjustments in order to address the underlying problems exposed by the crisis. In the first instance, assuming that exchange rates in crisis countries and other emerging market economies remain unchanged, this will imply a large positive swing in affected countries' current accounts – estimated at about $70 billion for 1998 and 1999 together – as well as a sharp slowdown in growth of world trade.

The impact that such an adjustment will have on OECD countries' economies is likely to be significant. Nevertheless, growth prospects for 1998–99 remain relatively favourable for the OECD area as a whole (Table 1).[1] Economic activity should expand at a rate around 2½% in 1998 and 1999, only slightly below the rates projected in the previous *OECD Economic Outlook*. Inflation is expected to be low nearly everywhere (Table 2), although unemployment will remain high in the area as a whole (Table 3).

1. **OECD Economic Outlook**, *No. 63, OECD Publications, Paris, 1998.*

Most of the downward revision to the projections for activity is accounted for by a markedly weaker picture for Japan and Korea. In most OECD countries outside Asia, the underlying economic situation is generally more positive than expected earlier, and policy responses and other forces acting on the economy, such as significantly lower long-term interest rates, are likely to mitigate the adverse effects of the crisis.

In Japan, the already poor economic situation, as well as the existing weakness of the financial system, has been aggravated by the Asia crisis. The use of monetary policy to provide stimulus to the economy is severely constrained by very low short-term interest rates. Moreover, the fragility of the banking sector, by impeding intermediation, is contributing to the sluggishness of activity. Although the government introduced a supplementary fiscal package last December, its effect will be limited in stimulating the economy because of the announced temporary nature of the personal income-tax cuts. Consequently, Japan might register a decline in output this year and a growth rate of only some 1¼% in 1999, in the absence of further policy changes.

The difficulty experienced by the Japanese authorities in putting in place policies to

Table 1
Growth of Real GDP in the OECD Area
%

	Change from previous year			
	1996	1997	1998	1999
Canada	1.2	3.8	*3.3*	*3.0*
France	1.5	2.4	*2.9*	*2.8*
Germany	1.4	2.2	*2.7*	*2.9*
Italy	0.7	1.5	*2.4*	*2.7*
Japan	3.9	0.9	*–0.3*	*1.3*
United Kingdom	2.2	3.3	*1.7*	*1.8*
United States	2.8	3.8	*2.7*	*2.1*
Total of above 7 countries	**2.5**	**2.8**	***2.1***	***2.1***
Australia	3.7	2.7	*3.2*	*3.2*
Austria	1.6	2.1	*2.7*	*2.9*
Belgium	1.5	2.7	*2.7*	*2.8*
Czech Republic	3.9	1.0	*0.9*	*1.2*
Denmark	3.5	3.4	*3.0*	*2.8*
Finland	3.6	5.9	*4.2*	*3.0*
Greece	2.7	3.5	*3.0*	*3.4*
Hungary	1.3	3.8	*4.3*	*4.6*
Iceland	5.5	5.0	*4.6*	*3.4*
Ireland	7.7	10.5	*8.6*	*6.6*
Korea	7.1	5.5	*–0.2*	*4.0*
Luxembourg	3.0	3.7	*3.4*	*3.5*
Mexico	5.2	7.0	*5.3*	*4.9*
Netherlands	3.3	3.3	*3.7*	*3.2*
New Zealand	2.7	2.8	*3.1*	*3.4*
Norway	5.3	3.5	*4.1*	*3.0*
Poland	6.1	6.9	*5.8*	*5.6*
Portugal	3.0	3.5	*3.8*	*3.2*
Spain	2.3	3.4	*3.5*	*3.3*
Sweden	1.3	1.8	*2.6*	*2.4*
Switzerland	–0.2	0.7	*1.5*	*1.8*
Turkey	7.2	6.3	*5.5*	*5.0*
Total of above 22 countries	**4.0**	**4.3**	***3.4***	***3.6***
Total OECD	**2.8**	**3.1**	***2.4***	***2.5***

Figures in *italics* are provisional.
Source: OECD

Table 2
Private Consumption Deflators in the OECD Area
%

	Change from previous year			
	1996	1997	1998	1999
Canada	1.5	1.8	*1.3*	*1.6*
France	1.8	1.2	*1.0*	*1.3*
Germany	2.0	1.9	*1.7*	*1.7*
Italy	4.4	2.4	*2.3*	*2.0*
Japan	0.1	1.6	*0.5*	*0.1*
United Kingdom	2.5	2.1	*2.4*	*2.6*
United States	2.4	2.0	*1.0*	*1.7*
Total of above 7 countries	**2.0**	**1.9**	***1.2***	***1.4***
Australia	2.0	1.3	*1.8*	*2.6*
Austria	2.5	1.5	*1.4*	*1.5*
Belgium	2.3	1.6	*1.0*	*1.2*
Czech Republic	7.8	8.8	*11.5*	*9.6*
Denmark	1.9	1.7	*2.3*	*2.6*
Finland	1.6	1.4	*1.9*	*2.0*
Greece	8.5	5.5	*4.9*	*3.4*
Hungary	21.7	18.1	*15.6*	*13.1*
Iceland	2.3	1.8	*2.4*	*3.2*
Ireland	1.1	1.2	*3.1*	*3.3*
Korea	6.0	4.5	*10.5*	*6.6*
Luxembourg	1.4	1.4	*1.1*	*1.3*
Mexico	28.8	20.4	*13.1*	*9.5*
Netherlands	1.3	2.1	*1.9*	*2.1*
New Zealand	2.0	1.5	*1.9*	*1.7*
Norway	1.1	2.8	*2.5*	*2.9*
Poland	19.9	14.9	*12.1*	*9.6*
Portugal	3.1	2.2	*2.1*	*2.0*
Spain	3.4	2.5	*2.2*	*2.5*
Sweden	1.2	2.2	*1.5*	*1.7*
Switzerland	1.1	0.7	*0.5*	*1.3*
Turkey	74.1	80.5	*75.0*	*65.0*
Total of above 22 countries	**13.1**	**11.7**	***10.8***	***9.1***
Average OECD	**4.4**	**4.1**	***3.3***	***3.1***
Average OECD *less* high-inflation countries[1]	2.1	2.0	*1.5*	*1.7*
European Union	2.6	2.0	*1.9*	*1.9*

Figures in *italics* are provisional.
1. Countries which have had 10% or more inflation in terms of GDP deflator on average during the 1990s on the basis of historical data. Greece, Hungary, Mexico, Poland and Turkey are thus excluded from the aggregate.
Source: OECD

promote and sustain the economic recovery underlines the importance of a more comprehensive approach, encompassing both macro-economic policies and structural reforms aimed at restoring private-sector confidence and putting the Japanese economy on a firm footing. In particular, the design of any future fiscal stimulus should favour measures that underpin sustained growth, rather than those of a more temporary nature. It has been suggested that a supplementary fiscal package might be considered early in fiscal year 1998 (which begins in April). Such a package would be welcome, as it would contribute to overcoming the restrictiveness of the current stance of fiscal policy. It would have more chance of success in providing support to activity if it were based on permanent tax reductions or on increases in public investment that has a high economic efficiency.

An important part of the necessary structural reforms requires dealing with the extensive financial-sector difficulties. An immediate priority is to address long-standing balance-sheet problems of the banking sector and improve the regulatory and supervisory framework. Important initiatives have already been announced by the Japanese authorities, but they will require careful implementation, in particular as regards the effective allocation and use of public funds, in order to put the financial system on a sound basis. Furthermore, product-market competition should be enhanced through, in particular, an ambitious and sustained programme of regulatory reform. Structural reforms are fundamental to the improvement of Japanese medium- to longer-term prospects. Moreover, by raising GDP, they would facilitate the achievement of the government's medium-term objective of fiscal restraint, which remains a priority once the recovery becomes firmly established in view of the pressures that an ageing population will exert on public finances.

In Korea, recent signs are that the financial situation, though fragile, is stabilising, with some recovery of the won, stronger equity markets and a cautious revival of capital inflows. However, domestic demand will weaken sharply this year and, despite a strong contribution from net export growth, real output will stagnate at best. At the same time, unemployment and inflation are set to increase substantially. To address the underlying weaknesses of the economy, the Korean authorities have already initiated a wide range of structural measures. Their full and rapid implementation should strengthen confidence further and contribute to easing financial conditions that are currently very tight. This would provide scope for reducing policy-controlled interest rates and set the stage for a recovery of the economy next year.

In the United States, where the economy has been operating above potential for some time, the Asia crisis has *de facto* been helpful to macro-economic management in reducing the risk of over-heating. The weakening of US exports, together with the effects of dollar appreciation on import prices, has reduced the requirement for increases in policy-controlled interest rates. The inherent uncertainty of the present situation probably continues to favour a wait-and-see attitude on the part of US monetary authorities. Nevertheless, labour markets remain tight and wage growth is on a rising trend. Moreover, asset markets are buoyant and property prices have started to accelerate. Thus, inflation pressures could emerge as soon as the situation stabilises in Asia and temporary factors

contributing to the present favourable outlook wear off. Largely reflecting the effects of the Asia crisis, the US external position is likely to deteriorate substantially over the next two years, reaching a deficit of almost 3% of GDP in 1999. Given that the budget deficit has moved into balance, this widening in the current-account deficit mainly reflects an insufficient volume of private saving. In view of the difficulty of designing effective policies to stimulate private saving, it might be desirable for the federal government to run budget surpluses in the years to come, especially as the surplus on social security will decline over time.

The situation has been improving in Europe. Growth has slowed to sustainable rates in some of the countries that risked overheating, while in most countries in the prospective euro area, the recovery seems to have become more broadly based, with domestic demand finally picking up. Although final decisions concerning participation in the European Monetary Union will be made in early May, the recently published reports by the European Commission and the European Monetary Institute point to 11 candidate countries having achieved sufficient convergence for eligibility. Financial markets expect the convergence process to continue to take place rather smoothly, as evidenced by the narrowing of intra-European long-term interest-rate spreads. Nevertheless, it is important that countries in the future euro area do not content themselves with the reductions in public deficits that have been achieved so far. Further progress in these – and in a number of other EU countries not set to participate in the single currency area in 1999 – is required to ensure that fiscal positions are maintained on a sustainable path over the longer term.

Table 3
Unemployment in the OECD Area[1]

	Thousands	% of labour force			
	1994	1996	1997	1998	1999
Canada	1,536	9.7	9.2	*8.6*	*8.3*
France	3,098	12.3	12.4	*11.9*	*11.3*
Germany	3,698	10.3	11.4	*11.5*	*11.1*
Italy	2,561	12.1	12.3	*12.0*	*11.8*
Japan	1,919	3.4	3.4	*3.5*	*3.6*
United Kingdom	2,670	8.0	6.9	*6.8*	*7.2*
United States[2]	7,976	5.4	4.9	*4.8*	*5.0*
Total of above 7 countries	**23,458**	**7.0**	**6.8**	*6.7*	*6.7*
Australia	852	8.5	8.6	*8.1*	*7.7*
Austria	215	6.3	6.2	*6.1*	*5.9*
Belgium	554	12.8	12.7	*12.3*	*11.9*
Czech Republic	166	3.5	4.4	*5.8*	*6.6*
Denmark	343	8.6	7.6	*6.7*	*6.2*
Finland	456	16.3	14.5	*12.4*	*11.0*
Greece	403	10.3	10.4	*10.6*	*10.6*
Hungary	449	10.0	8.7	*7.8*	*7.3*
Iceland	6	4.4	3.9	*3.5*	*3.4*
Ireland	210	11.9	10.2	*9.3*	*8.2*
Korea	489	2.0	2.6	*5.7*	*6.3*
Luxembourg	5	3.3	3.6	*3.6*	*3.5*
Mexico[3]	559	5.5	3.7	*3.4*	*3.4*
Netherlands	486	6.7	5.6	*5.1*	*4.8*
New Zealand	138	6.1	6.7	*6.7*	*6.4*
Norway	117	4.9	4.1	*3.3*	*3.0*
Poland	2,474	12.3	11.2	*10.1*	*9.3*
Portugal	312	7.3	6.7	*6.3*	*6.0*
Spain[4]	3,724	22.2	20.8	*19.6*	*18.4*
Sweden	339	8.1	8.0	*6.7*	*6.2*
Switzerland	171	4.7	5.2	*4.5*	*4.1*
Turkey[5]	1,740	6.0	5.7	*5.6*	*5.6*
Total of above 22 countries	**14,208**	**8.6**	**8.0**	*7.9*	*7.7*
OECD Total	**37,666**	**7.5**	**7.2**	*7.1*	*7.0*
European Union	19,075	11.4	11.2	*10.9*	*10.5*

Figures in *italics* are provisional.
1. Commonly used definitions.
2. Break in series from January 1994.
3. Figures based on the national survey of urban employment.
4. Rebased.
5. Important revisions to data.
Source: OECD

The most pressing policy issue facing countries set to participate in the European Monetary Union still remains the implementation of reforms to reduce high volumes of structural unemployment and increase the adjustment capacity of the economies. At this stage, it cannot be taken for granted that the advent of monetary union will create discipline and ensure a more rapid structural adjustment in the coming years. Consequently, authorities should take the opportunity offered by the current and projected favourable economic situation to make significant progress in the implementation of reforms that are essential to ensure the smooth functioning of EMU. Apart from labour-market reform, it will be important that pension and fiscal reform, banking-sector restructuring, competition policy and regulatory reform proceed at a faster pace and in a more uniform way across countries.

In sum, while the Asia crisis undoubtedly represents a shock for the world economy, its adverse impact is likely to be limited for countries outside the Asian region. Affected countries should gradually recover, provided that policies currently being implemented proceed as effectively and rapidly as possible. Stable macro-economic policies and sound financial structures, in particular as regards supervisory and regulatory frameworks, are essential to the proper functioning of globalised financial markets. In order to successfully overcome this crisis, it is important that the foundations for liberalised financial markets be strengthened and that the adjustments in external positions that are taking place not be thwarted by a rise in protectionist pressures.

3 April 1998

Ministerial Communiqué

The OECD Council at Ministerial level met on 27-28 April 1998 under the chairmanship of Mr Jaime Gama, Minister of Foreign Affairs, and Mr António Sousa Franco, Minister of Finance, of Portugal, assisted by the vice-chairs from Hungary and Korea. Prior to the meeting, the Chairman led consultations with the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) to the OECD; both organisations submitted statements for the consideration of Ministers. Ministers discussed key policy challenges of the globalising economy which they face in meeting the aspirations of their citizens – promoting economic growth and employment through sound macro-economic policies and structural reform; the better integration of environmental, social and economic policies; and the strengthening of the multilateral system – thereby ensuring sustainable development and a durable improvement in living standards. They focused also on the global implications of the financial and economic situation in Asia. Against this background, Ministers discussed the role of the OECD, its achievements and future work.

Economic Growth, the Global Implications of the Asian Crisis and the Multilateral System

Ministers noted that the Asian financial crisis has highlighted the growing interdependence of countries in the world economy as well as the importance of having well-functioning markets and efficient economies and supportive mechanisms of international co-operation and solidarity. They believe that recent events have confirmed that good governance and effective structural policies – concerning financial systems, regulatory reform, corporate governance, and labour and product markets – together with stable macro-economic policies based on sound and transparent public finances and control of inflation, are critical to good economic performance, employment, social cohesion and the smooth functioning of the global economy. Ministers stressed the importance of a quick return to financial stability and economic growth in Asia through the rapid implementation of the macro-economic and structural reforms necessary for recovery. They called on OECD countries to contribute to that recovery with policies that sustain growth and domestic demand, further open markets and improve conditions for investment. In this regard, domestic demand-led growth in Japan would contribute significantly.

Ministers welcomed reforms being undertaken by countries in Asia and recognised their growth potential over the longer term but also urged countries affected by the crisis to implement fully and expeditiously the recommended reforms agreed with the IMF, the World Bank and other relevant international institutions. The events in Asia have underlined the importance of international monetary and financial co-operation and of the advantages of all parties working together in a co-ordinated manner to prevent, manage and contribute to overcoming crises of a global nature.

Bearing in mind the upcoming WTO Ministerial, Ministers also noted that the impact on trade and investment of the current financial and economic situation in Asia poses challenges for the multilateral system. All countries have a substantial stake in economic stability and development in the Asian region. Ministers agreed on the importance of all countries maintaining open markets, resisting protectionist pressures, sustaining the momentum for future broad-based liberalisation building further on current levels of market access, undertaking regulatory and structural reform, and providing a receptive climate for investment. Ministers confirmed the importance of stable trade financing facilities and of providing development assistance, as appropriate, targeted to help address the economic and social implications of the financial crisis for affected Asian countries.

Ministers reaffirmed the Organisation's commitment to contribute to the international effort, led by the international financial institutions, to overcome the Asian financial crisis as rapidly as possible, through policy dialogue and co-operation in its areas of expertise. They stressed the important role of the OECD's peer review mechanism in contributing to sound macro-economic and structural policy environments in Member countries. They endorsed the establishment of an OECD special programme addressing structural issues arising from financial instability in non-member economies, to complement on-going co-operation with emerging and transition economies in Asia and elsewhere. In this context, Ministers welcomed the commitment on the part of

many non-OECD countries to a path of continued liberalisation, structural reform, good governance and the maintenance of a favourable investment climate, which contribute both to the good performance of those economies and to a strengthened multilateral system.

Ministers noted that, despite the effects of the Asian financial crisis, the underlying economic situation in most OECD countries is generally good, with sustained output growth and low inflation expected in nearly all. Economic growth in 1998-99 is projected to average around 2½% in the OECD area, though with very different prospects across the regions, including some strengthening of growth in continental Europe, marked weakness in Korea and the prospect of a resumption of growth in Japan with its stimulus package. Nevertheless unemployment remains at over 7%, some 35 million persons, for the area as a whole and it is forecast to remain around 10% in Europe.

In this context, Ministers discussed recent policy developments and challenges facing OECD countries. They confirmed their commitment to pursue policies to achieve strong sustainable growth and reaffirmed the need for macro-economic policies focused on sound public finances and effective control of inflation. They also agreed on the need for fiscal consolidation over the medium term in most OECD countries, in order to reduce debt levels and help meet the challenge of ageing populations. Where tax burdens are high and action is still needed to reduce deficits, the main efforts should involve containing expenditures, although tax reform may also have a role to play. Different cyclical positions may call for different policy settings in the short term, however. In particular:

• in the United States, a general government budget surplus has been achieved for the first time in decades. The policy framework there should continue to be directed at sustainable expansion and to increasing national saving. At the same time, given the tight labour market, any possible resurgence of inflationary pressures in that country should be watched carefully

• with respect to the European Union, Ministers welcomed the convergence of budget deficits and inflation rates in EU economies, as this will allow the EMU to come into being on a broad base. Three OECD Member countries have so far entered the EU enlargement process, and Ministers encouraged them to continue with efforts toward necessary macro-economic and structural adjustments that they have been undertaking. Continued pursuit of sound and credible macro-economic policies, within the stability framework, together with the pursuit of structural reforms, is critical for job creation and sustainable non-inflationary growth throughout the EU. However, it is important that recovery in EMU participating countries be increasingly based on sustained growth of domestic demand

• ministers welcomed the substantial policy measures announced April 24 by the Government of Japan aimed at achieving domestic demand-led growth. They noted the intention of the Government of Japan to put the measures in the package into place quickly. Ministers noted that further progress in the strengthening of the financial system and in structural reform would help establish a sound basis for sustainable growth led by domestic demand. Over the longer term, fiscal consolidation remains an important goal in a rapidly ageing society

• ministers welcomed the efforts by Korea to overcome its economic difficulties through the implementation of its programme of reforms. Continued vigorous pursuit of the reform package, including financial reforms, improved corporate governance and enhanced competition through more liberal and non-discriminatory trade and investment policies, supported by continued high savings and an educated workforce, is necessary to restore economic prospects and put the economy back on the medium-term track of high growth.

Ministers recognised the importance of having an open and well-informed public debate on trade and investment liberalisation in the globalising world economy, in light of public concerns about the effects of such liberalisation. They welcomed the Organisation's study 'Open Markets Matter: The Benefits of Trade and Investment Liberalisation', which outlines the substantial gains to be made through continued liberalisation by all countries to promote efficiency, innovation and consumer choice; develop better quality goods and services; raise incomes; and sustain economic growth and net job creation. Ministers noted that liberalisation is one important component, among others, of what must be a coherent set of policies aimed at achieving a durable improvement in living standards. At the same time, there is a need to ensure that the gains from liberalisation are as widely shared as possible, and that policies are in place to help, in particular, those most affected by adjustment. Bearing in mind the need to build public support for the multilateral system, Ministers agreed accordingly on the importance of ensuring maximum possible transparency.

Ministers agreed to a statement on the Multilateral Agreement on Investment (box, p. 50).

Ministers are convinced that globalisation offers great opportunities to enhance economic growth and improve welfare, both in Member and non-member economies. They recognised that these benefits will be fully realised and widely shared only if structural reforms are adopted which encourage and facilitate governments, firms, and citizens to successfully adjust and innovate, taking into account the needs of the most vulnerable and the need to prevent people from drifting into long-term unemployment and social exclusion. Ministers agreed to pursue policies to that effect, taking into account the need to integrate economic, social and environmental objectives in promoting sustainable development.

In that context, Ministers agreed that action is needed to secure: sound macro-economic conditions and financial systems; comprehensive reforms in both labour and product markets and tax and welfare systems; strategies for lifelong learning in the public and private sectors; an adequate response to the social, fiscal and financial implications of ageing populations; better corporate governance and regulatory practices; the effective development and utilisation of new technologies including in electronic commerce; the full benefits of trade and investment liberalisation; and sustainable development. Ministers called on the OECD to contribute to this

ambitious agenda by charting the way in which countries can best take advantage of the opportunities and meet the challenges of globalisation.

Promoting Structural Reform and Adjustment

Implementing the Jobs Strategy

Ministers agreed that reducing high and persistent unemployment remains a top priority for many countries, especially in Europe. Ministers are particularly concerned about the persistence of high long-term and youth unemployment, as well as decreasing employability among older workers, in many OECD economies. There is evidence that unemployment is now largely structural in OECD countries, although there are still some where cyclical unemployment remains high. There is also mounting evidence that the OECD Jobs Strategy, implemented comprehensively and tailored to the specific conditions in each country, represents an effective means of promoting employment and responding to countries' labour-market problems. Ministers therefore emphasised the importance of the full implementation of the Strategy. They requested a comprehensive review of progress in this area in 1999, to aid them in implementing necessary reforms. Ministers also noted growing regional disparities in unemployment and widening income disparities in a number of countries and the importance of addressing these issues . They welcomed the specific initiative by the Organisation focusing on youth unemployment, which OECD Labour Ministers had recommended at their meeting in October 1997.

Ministers agreed that, as discussed at the OECD Industry Ministers' meeting in February, fostering entrepreneurship and improving the conditions for the creation and growth of small- and medium-sized enterprises are important for achieving better economic performance and improved job prospects, as well as for reducing regional economic disparities. They aim to improve the conditions for entrepreneurial activity, in particular by ensuring that capital markets, tax systems, administrative and regulatory conditions, infrastructure, and the labour and product market environment, provide a suitable setting. They noted the rapid growth and stressed the increasing importance of services, their connections with industry, and their impact on competitiveness.

Ministers also recognised the important role of technology in driving productivity advances and thus economic growth. Technological change leads to shifts in the pattern of labour demand, reducing the demand for some types of employment and increasing the demand for others. Policy should thus be geared not only to fostering innovation and technology diffusion, but also to facilitating the ability of both firms and individuals to adapt to technological change, thereby reaping the full benefits of productivity improvements and generating positive effects on jobs.

Taking full advantage of technological opportunities requires an appropriately-skilled workforce. Ministers agreed on the importance of effective education and training systems, as well as lifelong learning for all, to ensure that people are adequately equipped, or re-equipped, for the jobs of the future. Particular attention should be paid to efficiently assisting the most vulnerable in society who may be less able to

The Multilateral Agreement on Investment (MAI)

Ministers regard investment, like trade, as an engine of economic growth, employment, sustainable development and rising living standards in both developed and developing countries. They re-affirm the importance they attach to achieving a comprehensive multilateral framework for investment with high standards of liberalisation and investment protection with effective dispute settlement procedures, and open to non-member countries. They also recognise the importance of the public debate on the implications of globalisation.

Ministers welcome the Report by the Chairman of the Negotiating Group on the progress made since the Ministerial meeting of May 1997 in developing a Multilateral Agreement on Investment (MAI).

Taking into account the positive results produced by the Negotiating Group, as well as the remaining difficulties and the concerns that have been expressed, Ministers decide on a period of assessment and further consultation between the negotiating parties and with interested parts of their societies, and invite the Secretary-General to assist this process. Ministers note that the next meeting of the Negotiating Group will be held in October 1998. Ministers direct the negotiators to continue their work with the aim of reaching a successful and timely conclusion of the MAI and seeking broad participation in it. In the same spirit, they support the current work programme on investment in the WTO and once the work programme has been completed will seek the support of all their partners for next steps towards the creation of investment rules in the WTO.

Ministers recognise the need to complete work on MAI disciplines and exceptions with a view to achieving a high standard of liberalisation and a satisfactory balance of commitments, which takes full account of economic concerns and political, social and cultural sensitivities. A solution is also needed for particular issues relating to extraterritoriality.

Ministers confirm that the MAI must be consistent with the sovereign responsibility of governments to conduct domestic policies. The MAI would establish mutually beneficial international rules which would not inhibit the normal non-discriminatory exercise of regulatory powers by governments and such exercise of regulatory powers would not amount to expropriation.

Ministers note the increased convergence of views on the need for the MAI to address environmental protection and labour issues, and the broad support for including a strong commitment by governments not to lower environmental or labour standards in order to attract or retain an investment.

Ministers are committed to a transparent negotiating process and to active public discussion on the issues at stake in the negotiations.

Ministers welcome the full participation as Observers of Argentina, Brazil, Chile, Estonia, Hong Kong, China, Latvia, Lithuania and the Slovak Republic with a view to their becoming founding members of the MAI. Ministers are committed to pursue an active dialogue with non-members, including on their development interests, particularly with those non-members willing and able to meet the obligations of the agreement.

take advantage of education and training programmes.

Improving Strategies for Ageing and Social Policy

Ministers discussed the challenges of ageing populations, a major priority for policy-makers, recognising that demographic and labour market trends in most OECD countries are likely to result in increasing numbers of people who are not working relative to working people, especially from 2010. They welcomed the report 'Maintaining Prosperity in an Ageing Society' which proposes principles for interrelated reforms in many areas of social, economic and financial policy, in particular for health care and pensions systems. Societies must foster a climate conducive to 'active ageing', providing support for people to lead active lives as they grow older. Ministers agreed to take into account these principles in developing national strategies and to monitor progress through the OECD.

Reform of social policy more generally figures high on the agenda of most OECD countries. The 'Initiative for a Caring World' is contributing to a useful sharing of national experiences. Social policy should be more cost-effective and emphasise integration into the labour market in order to be more responsive to the needs of all people, especially the most vulnerable, and thereby strengthen social cohesion and contribute to overcoming poverty. Ministers look forward to the recommendations of OECD Social Policy Ministers, who will meet in June, on how the Organisation might best contribute to achieving these objectives.

Governance and Regulatory Issues

Ministers welcomed the analytical work of the OECD on corporate governance. They called on the OECD to develop, in conjunction with national governments, other relevant international organisations and the private sector, a set of standards and guidelines in this field, taking into account factors which influence business practices in each country, and to report on these by the 1999 Ministerial.

Ministers also noted that the quality of public sector management is essential for effective government and encouraged comparative analysis in this area. They welcomed the recent approval of the OECD Recommendation on Improving Ethical Conduct in the Public Service in Member countries, and asked to receive a report on this issue in 2000.

Ministers also reiterated the importance of regulatory reform in increasing economic growth and efficiency, and the ability of economies to adapt. The launch of the country review process, initially involving the Netherlands, the United States, Japan and Mexico, will contribute to Member countries' efforts in this regard. They look forward to receiving a synthesis report on these reviews in 1999. They wish to enhance this process with reviews of additional Member countries in 1999 and beyond.

The Electronic World

The electronic world has potentially far-reaching implications for many facets of life, including the organisation of work and employment, the means of conducting commercial transactions, and the operation of government and the private sector. It also provides new business challenges and opportunities, including for small and medium-sized enterprises. To help this technology reach its potential, Ministers expressed their intention to work for agreement in the WTO on trade aspects relating to electronic commerce. Ministers welcomed the OECD's work on electronic commerce, recognising that the Organisation is well placed to examine the economic and social implications of these new technologies, and to contribute in specific areas such as trade policy, taxation, electronic authentication, consumer protection, privacy and security. They look forward to the ministerial conference on electronic commerce, to be held in Ottawa in October. That Conference will seek to develop, in consultation with the private sector and other international organisations, a coherent 'action plan' for public policy and self-regulatory action, with the goal of realising the potential of global electronic commerce.

As the year 2000 approaches, Ministers agreed on the importance of rapidly adapting computer systems in order to avoid the potential for significant disruption due to the so-called 'millennium bug'. They stated their intention to meet this challenge and recognised the need to exchange information among governments and to work with the private sector, as appropriate, to ensure that the problem is resolved in a timely and comprehensive manner. They also called on the OECD to promote global awareness of the Year 2000 problem and its potential economic impact, and to report to the Ottawa ministerial conference on electronic commerce.

Strengthening the Multilateral System

In view of the upcoming WTO Ministerial, which is being held in conjunction with the 50th anniversary of the multilateral trading system, Ministers reaffirmed their strong commitment to the multilateral system. They attached the utmost importance to maintaining open markets and sustaining the momentum of liberalisation. They stressed their resolve to ensure full and timely implementation of the Uruguay Round agreements, to strictly adhere to WTO rules, and to pursue the process of broad-based trade liberalisation, including in new areas. To this effect Ministers encouraged vigorous efforts in the WTO based on the built-in agenda agreed at the end of the Uruguay Round, together with the WTO work programme as agreed at Singapore. Ministers welcomed that exploration of the possible scope and modalities for further liberalisation and rulemaking had begun and stressed the importance of advancing toward an international consensus. In this context, Ministers expressed their support for complementing existing WTO mandates by addressing remaining barriers to trade in industrial products and for further liberalisation in the information technology area. Ministers reaffirmed the OECD's important role in support of the multilateral system and the WTO's preparations for future negotiations. They recognised that further integration of developing and transition countries into the multilateral system remains a high priority, and that it is important to remain responsive to their needs. In this context, particular attention should be given to enhancing opportunities for the least

developed countries, and to helping them build the capacities needed to benefit from those opportunities. Ministers also supported the early accession on commercially viable terms of applicants to the WTO, while preserving the integrity of WTO rules.

Ministers noted that OECD Agriculture Ministers had, at their March meeting, reaffirmed that, in conformity with the conditions of Article 20 of the Uruguay Round Agreement on Agriculture and including all the elements contained therein, further trade negotiations are due to continue the ongoing process towards the long-term objective of substantial progressive reductions in support and protection resulting in fundamental reform. Ministers also noted that Agriculture Ministers had adopted a broad set of shared goals and policy principles covering all aspects of agricultural policy reform, and that those Ministers had: stressed that agro-food policies should seek to strengthen the intrinsic complementarities between the shared goals, thereby allowing agriculture to manifest its multifunctional character in a transparent, targeted and efficient manner; and had agreed that the challenge in pursuing the shared goals is to use a range of well-targeted policy measures and approaches which can ensure that the growing concerns regarding food safety, food security, environmental protection and the viability of rural areas are met in ways that maximise benefits, are most cost-efficient, and avoid distortion of production and trade.

Ministers also renewed their support for the observance of internationally recognised core labour standards and the goal of reaching agreement on an ILO declaration and follow-up mechanism. They noted the important role of the social partners in the process. Ministers also rejected use of labour standards for protectionist purposes.

Ministers reaffirmed their commitment to the OECD Guidelines for Multinational Enterprises, and to continue to update them in a timely manner, to ensure their relevance and effectiveness.

Ministers urged the early ratification of the OECD Shipbuilding Agreement by all participants to establish normal competitive conditions within the international shipbuilding market and to encourage other countries to become parties to the Agreement. Noting that the Agreement's original target date for implementation was January 1996, Ministers called on all signatories to ratify the Agreement as quickly as possible.

Ministers noted with satisfaction the 20th anniversary of the Export Credit Arrangement. It has proved to be a highly successful means of achieving rules-based disciplines on export credits. They welcomed the positive efforts undertaken in the area of premia following the adoption of the 1997 Guidelines. Ministers regretted, however, that an Understanding covering agricultural export credits has not been concluded, but remain convinced that the appropriate forum in which to continue debating the matter is provided by the meetings of the Participants to the Arrangement. Noting the outstanding undertaking on this issue in the Uruguay Round Agreement on Agriculture, they urged the Participants to reach an agreement as soon as possible and to report back on this matter at their 1999 Ministerial meeting.

Ministers welcomed the signing in December 1997 of the Convention on Combating Bribery of Foreign Public Officials and the subsequent legislative steps taken by Participating countries. They underlined their commitment to speedy ratification and implementation to allow the Convention to enter into force by 31 December 1998. They stressed the importance for all Participating countries to eliminate tax deductibility of bribes. Finally, they asked for a report in 1999 on the implementation of the Convention and on the progress made in the work planned on the following issues: bribery acts in relation with foreign political parties; advantages promised or given to any person in anticipation of that person becoming a foreign public official; bribery of foreign public officials as a predicate offence for money laundering legislation; the role of foreign subsidiaries and of offshore centres in bribery transactions. Ministers asked the OECD to promote wider participation in the Convention and its follow-up among non-participating countries.

Ministers welcomed the decision of the Financial Action Task Force (FATF) Ministerial meeting to extend its work for a further five years and the new strategy it has adopted. They also noted the FATF decision to promote the establishment of a world-wide anti-money laundering network based on adequate expansion of membership.

Ministers[1] welcomed the Report 'Harmful Tax Competition: an Emerging Global Issue' and recognised that it represents a step forward towards curbing harmful tax practices. Ministers underlined the commitment to intensify efforts in this area at the national, bilateral, and multilateral levels. They welcomed the establishment of Guidelines on Harmful Preferential Tax Regimes, the commitment to draw up a list of tax havens and the creation of a Forum on Harmful Tax Practices. Ministers look forward to receiving periodic reports on the progress in implementing the recommendations set out in the Report.

Ministers encouraged the OECD to pursue further, and to broaden, its work in order to carry out fully the mandate given by Ministers in 1996 to develop measures to counter the distorting effect of harmful tax competition on investment and financial decisions, including real economic activities, and to associate non-member countries with this work.

Ministers also welcomed the OECD Recommendation on measures against 'hard core' cartels which was agreed in March. They called on Member countries to halt and deter the operations of such cartels, which have damaging effects on consumers and businesses around the world and to co-operate in their efforts to this end. They invited non-member countries to associate themselves with the Recommendation.

OECD's Current and Future Challenges

Ministers noted with satisfaction the measures undertaken over the last year to improve the coherence and efficiency of the OECD's co-operative relations with non-members. They urged the Organisation to continue to strengthen these relations in a flexible and open but differentiated way, on a basis of mutual interest, with both emerging and transition economies. The

ongoing, mutually beneficial dialogue should focus increasingly on the core activities of the Organisation, and on issues of particular importance for the successful integration of these economies into the international economic system. Ministers welcomed the growing interest of non-members in participating in the work of the Organisation.

Ministers reiterated that the OECD must remain open, on the basis of mutual interest, to membership by countries sharing the same values, while being selective and preserving the Organisation's tradition of high standards for membership, as well as its efficiency and relevance to its Members. Ministers also welcomed the continuing commitment to market-oriented reform by the Russian government. They called on the Russian Federation to participate more fully in co-operative activities with the OECD, which aim to help Russia establish a fully-fledged market economy within the framework of effective democratic institutions, as well as to meet and sustain the necessary conditions for future membership of the Organisation, the ultimate shared goal of both parties. They welcomed the continuing interest of certain emerging and transition countries in OECD membership. Ministers agreed that the accession process of the Slovak Republic should be concluded as soon as this country is ready and able to share the common values and assume all the responsibilities of OECD Members.

Ministers welcomed the steady progress being made in implementing the OECD's partnership strategy to help developing countries build their own capacities for development. Dialogue and joint review with partner countries are pointing to concrete changes in strengthening their local ownership and reducing aid dependency. This strategic agenda involves work on: agreed indicators of progress in economic well-being, social development, environmental sustainability and good governance; as well as on tested poverty-reduction strategies. Its success will be based on increased policy coherence, especially to help developing countries secure sustainable development, assemble the necessary financial resources and integrate successfully into the global economy. Ministers requested the Secretariat to submit a report to their meeting in 1999 on the links between trade and investment and development, and the role that the OECD might play in promoting greater policy coherence. At the same time, Ministers recognised the importance of substantial levels of official development assistance, in particular for the poorest countries, as a means of helping developing countries maximise their prospects for growth and for achieving the goals of the partnership strategy. They welcomed the work being undertaken to stem unproductive expenditure, including excessive military expenditure, in developing countries and recognised the importance of improving the coherence of Members' relevant policies and programmes with this aim. Ministers look forward to the scheduled full review in 1999 of the implementation of the development partnership strategy. Ministers welcomed the agreed mandate to work on a Recommendation on untying of official development assistance for the least developed countries, with a text to be proposed in 1999. They also welcomed the new Guidelines on Gender Equality and Women's Empowerment in Development Co-operation.

Ministers agreed that the achievement of sustainable development is a key priority for OECD countries. They encouraged the elaboration of the Organisation's strategy for wide-ranging efforts over the next three years in the areas of climate change, technological development, sustainability indicators, and the environmental impact of subsidies. They welcomed the Shared Goals for Action adopted by OECD Environment Ministers at their April meeting. Ministers recognised that all OECD countries, on the basis of their differentiated responsibilities, need to play their part in combating climate change by implementing national strategies, including measures such as clear targets and effective regulatory and economic measures, as well as through international co-operation. In this regard, OECD analysis will be critical in helping Member countries find the most efficient and effective ways to meet Kyoto targets. Ministers asked the OECD to enhance its dialogue with non-member countries in these areas and to engage them more actively, including through shared analyses and development of strategies for implementing sustainable development. Ministers further noted that, as part of the Shared Goals, Environment Ministers stressed the crucial importance of strong environmental policies in the implementation of sustainable development. Ministers agreed to interpret the term 'sustainable' as including social and environmental, as well as economic, considerations. The Organisation is well placed to exploit its multidisciplinary expertise in this area and to pursue the integration of economic, environmental and social policies to enhance welfare. In this regard, Ministers stressed the importance of promoting effective integration of environmental considerations in the multilateral system.

Ministers welcomed the Secretary-General's achievements in reforming the Organisation and emphasised the importance of the work currently underway on committee and directorate restructuring and on the decision-making process. They believe that continued efforts to renew, streamline and refocus the Organisation can further enhance its value as a resource for Member countries at a time of rapid change. They recognised the importance of returning the Organisation to a stable and predictable budgetary climate as soon as possible. Ministers called for renewed efforts to prioritise the OECD's work, recognising the important role that Members themselves must play in working with the Secretary-General in this regard. They stressed that the multidisciplinary, forward-looking nature of the Organisation's work is important in helping countries deal with the complex problems of a globalising world. Ministers noted the positive accomplishments of the OECD and encouraged the Organisation to continue to adapt to the changing needs of its Members. Ministers reaffirmed their strong support for the Organisation and committed to work toward strengthening its role in the global economy of tomorrow.

1. Luxembourg and Switzerland (for the reasons set out in Annex 2 of the Report) abstained in Council on the approval of the Report and the adoption of the Recommendation and are not bound by this text and its recommendations; accordingly they do not associate themselves with this paragraph.

Indicators

Definitions and Notes

Gross Domestic Product: *Volume series, seasonally adjusted except for Czech Republic and Portugal*
Leading Indicator: *A composite indicator, based on other indicators of economic activity (employment, sales, income, etc.), which signals cyclical movements in industrial production from six to nine months in advance*
Consumer Price Index: *Measures changes in average retail prices of a fixed basket of goods and services*
Current Balance: *$ billion; not seasonally adjusted except for Australia, the United Kingdom and the United States*
Unemployment Rate: *% of civilian labour force – standardised unemployment rate; national definitions for Czech Republic, Iceland, Korea, Mexico, Poland, Switzerland and Turkey; seasonally adjusted apart from Turkey*
Interest Rate: *Three months, except for Greece (twelve months) and Turkey (overnight interbank rate)*
.. not available
Source: **Main Economic Indicators**, *OECD Publications, Paris, May 1998.*

Australia

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.4	3.1
Leading Indicator	Mar. 98	0.1	2.3
Consumer Price Index	Q1 98	0.2	-0.2
		current period	same period last year
Current Balance	Q4 97	-3.97	-3.96
Unemployment Rate	Feb. 98	8.1	8.8
Interest Rate	Mar. 98	4.97	6.08

Austria

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 95	0.0	0.3
Leading Indicator	Mar. 98	0.4	4.5
Consumer Price Index	Mar. 98	0.1	1.0
		current period	same period last year
Current Balance	Dec. 97	0.54	1.11
Unemployment Rate	Feb. 98	4.4	4.3
Interest Rate	Mar. 98	3.60	3.34

Belgium

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	-0.4	2.6
Leading Indicator	Mar. 98	-0.3	-0.8
Consumer Price Index	Apr. 98	0.5	1.5
		current period	same period last year
Current Balance	Q4 97	3.88	3.44
Unemployment Rate	Feb. 98	9.0	9.3
Interest Rate	Mar. 98	3.64	3.45

Canada

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.7	4.2
Leading Indicator	Mar. 98	-0.4	0.0
Consumer Price Index	Mar. 98	0.1	0.9
		current period	same period last year
Current Balance	Q4 97	-3.56	0.72
Unemployment Rate	Mar. 98	8.5	9.3
Interest Rate	Mar. 98	4.85	3.20

Czech Republic

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	..	2.2
Leading Indicator		..	..
Consumer Price Index	Mar. 98	0.1	13.4
		current period	same period last year
Current Balance	Q4 97	-0.60	-1.44
Unemployment Rate	Mar. 98	5.3	3.8
Interest Rate	Apr. 98	15.47	12.27

Denmark

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	1.1	4.5
Leading Indicator	Feb. 98	0.1	7.0
Consumer Price Index	Mar. 98	0.2	2.3
		current period	same period last year
Current Balance	Q4 97	-0.87	-0.91
Unemployment Rate	Feb. 98	5.5	6.4
Interest Rate	Apr. 98	3.91	3.60

Finland

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	1.8	6.2
Leading Indicator	Oct. 97	-0.1	5.5
Consumer Price Index	Mar. 98	0.2	1.8
		current period	same period last year
Current Balance	Feb. 98	0.79	0.15
Unemployment Rate	Feb. 98	12.5	15.1
Interest Rate	Apr. 98	3.63	3.08

France

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.8	3.0
Leading Indicator	Mar. 98	0.9	5.4
Consumer Price Index	Mar. 98	0.2	0.8
		current period	same period last year
Current Balance	Jan. 98	5.20	6.21
Unemployment Rate	Feb. 98	12.1	12.3
Interest Rate	Apr. 98	3.63	3.40

Germany

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.3	2.3
Leading Indicator	Dec. 97	0.0	7.7
Consumer Price Index	Mar. 98	-0.2	1.1
		current period	same period last year
Current Balance	Feb. 98	0.05	-1.21
Unemployment Rate	Feb. 98	9.7	9.4
Interest Rate	Apr. 98	3.63	3.23

Greece

	period	% change from previous period	% change from previous year
Gross Domestic Product	1996		2.6
Leading Indicator	Mar. 98	-0.3	0.3
Consumer Price Index	Mar. 98	2.5	4.5
		current period	same period last year
Current Balance	Dec. 97	0.17	0.14
Unemployment Rate		..	..
Interest Rate	Feb. 98	12.70	10.71

Hungary

	period	% change from previous period	% change from previous year
Gross Domestic Product		..	..
Leading Indicator		..	..
Consumer Price Index	Feb. 98	1.7	17.1
		current period	same period last year
Current Balance		..	..
Unemployment Rate	Feb. 98	9.9	10.4
Interest Rate	Feb. 98	19.20	20.90

Iceland

	period	% change from previous period	% change from previous year
Gross Domestic Product	1996		5.5
Leading Indicator		..	..
Consumer Price Index	Apr. 98	0.2	1.9
		current period	same period last year
Current Balance	Q4 97	-0.05	-0.06
Unemployment Rate	Mar. 98	3.2	3.9
Interest Rate	Mar. 98	7.40	7.20

Ireland

	period	% change from previous period	% change from previous year
Gross Domestic Product	1996		8.6
Leading Indicator	Feb. 98	1.4	16.9
Consumer Price Index	Mar. 98	0.5	2.1
		current period	same period last year
Current Balance	Q3 97	0.77	0.93
Unemployment Rate	Feb. 98	9.6	10.6
Interest Rate	Apr. 98	6.14	6.25

Italy

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.2	2.8
Leading Indicator	Mar. 98	-0.2	7.7
Consumer Price Index	Apr. 98	0.2	1.8
		current period	same period last year
Current Balance	Dec. 97	2.84	1.23
Unemployment Rate	Jan. 98	12.0	12.1
Interest Rate	Mar. 98	5.62	7.43

Japan

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	-0.2	-0.2
Leading Indicator	Mar. 98	0.2	-2.9
Consumer Price Index	Mar. 98	0.4	2.2
		current period	same period last year
Current Balance	Feb. 98	13.22	6.86
Unemployment Rate	Jan. 98	3.5	3.3
Interest Rate	Feb. 98	1.01	0.55

Korea

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	-1.1	4.0
Leading Indicator		..	..
Consumer Price Index	Apr. 98	0.3	8.8
		current period	same period last year
Current Balance	Nov. 97	0.54	-2.07
Unemployment Rate	Mar. 98	5.3	2.9
Interest Rate	Feb. 98	22.50	12.30

Luxembourg

	period	% change from previous period	% change from previous year
Gross Domestic Product	1996		3.0
Leading Indicator	Mar. 98	-0.2	3.5
Consumer Price Index	Mar. 98	0.0	1.3
		current period	same period last year
Current Balance		..	..
Unemployment Rate	Feb. 98	3.4	3.6
Interest Rate		..	..

Mexico

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	-0.4	6.6
Leading Indicator	Jan. 98	0.5	4.1
Consumer Price Index	Mar. 98	1.2	15.3
		current period	same period last year
Current Balance	Q4 97	-3.62	-1.53
Unemployment Rate	Mar. 98	3.3	4.2
Interest Rate	Mar. 98	20.76	22.32

Netherlands

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.9	3.8
Leading Indicator	Mar. 98	-0.2	2.3
Consumer Price Index	Mar. 98	0.9	2.3
		current period	same period last year
Current Balance	Q2 97	4.64	4.96
Unemployment Rate	Jan. 98	4.7	5.8
Interest Rate	Apr. 98	3.56	3.20

New Zealand

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.1	2.1
Leading Indicator		..	..
Consumer Price Index	Q1 98	0.2	1.3
		current period	same period last year
Current Balance	Q3 97	-1.43	-1.35
Unemployment Rate	Q4 97	6.7	6.0
Interest Rate	Apr. 98	9.26	7.49

Norway

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	1.5	4.5
Leading Indicator	Mar. 98	0.7	2.5
Consumer Price Index	Mar. 98	0.5	2.3
		current period	same period last year
Current Balance	Q4 97	1.43	2.65
Unemployment Rate	Q4 97	3.8	4.8
Interest Rate	Mar. 98	4.08	3.51

Poland

	period	% change from previous period	% change from previous year
Gross Domestic Product		..	..
Leading Indicator		..	..
Consumer Price Index	Mar. 98	0.6	13.6
		current period	same period last year
Current Balance	Nov. 97	-0.28	-0.13
Unemployment Rate	Mar. 98	10.4	12.4
Interest Rate	Mar. 98	21.76	20.98

Portugal

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 96	1.2	4.5
Leading Indicator	Jan. 98	0.7	10.7
Consumer Price Index	Dec. 97	0.2	2.3
		current period	same period last year
Current Balance	Q4 97	-1.01	-0.87
Unemployment Rate	Feb. 98	6.6	7.2
Interest Rate	Apr. 98	4.47	5.97

Spain

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.9	3.6
Leading Indicator	Feb. 98	0.2	5.0
Consumer Price Index	Mar. 98	0.0	1.8
		current period	same period last year
Current Balance	Mar. 98	0.00	-0.06
Unemployment Rate	Feb. 98	20.0	21.3
Interest Rate	Apr. 98	4.41	5.57

Sweden

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	2.2	3.4
Leading Indicator	Mar. 98	0.4	6.0
Consumer Price Index	Mar. 98	0.2	0.7
		current period	same period last year
Current Balance	Feb. 98	0.66	0.47
Unemployment Rate	Feb. 98	9.0	10.9
Interest Rate	Apr. 98	4.47	4.03

Switzerland

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.5	1.9
Leading Indicator	Mar. 98	0.7	9.7
Consumer Price Index	Apr. 98	0.0	0.0
		current period	same period last year
Current Balance	Q4 97	5.77	6.04
Unemployment Rate	Mar. 98	4.4	5.4
Interest Rate	Mar. 98	1.07	1.78

Turkey

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q3 97	-2.5	7.0
Leading Indicator		..	..
Consumer Price Index	Apr. 98	4.7	93.6
		current period	same period last year
Current Balance	Q4 97	-1.35	-1.05
Unemployment Rate	Q2 97	5.9	6.3
Interest Rate	Mar. 98	80.60	65.12

United Kingdom

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q4 97	0.3	2.8
Leading Indicator	Mar. 98	0.1	1.2
Consumer Price Index	Mar. 98	0.3	3.5
		current period	same period last year
Current Balance	Q4 97	0.19	0.60
Unemployment Rate	Feb. 98	6.6	7.3
Interest Rate	Apr. 98	7.44	6.37

United States

	period	% change from previous period	% change from previous year
Gross Domestic Product	Q1 98	1.0	3.6
Leading Indicator	Mar. 98	1.2	5.5
Consumer Price Index	Mar. 98	0.2	1.4
		current period	same period last year
Current Balance	Q4 97	-45.62	-36.87
Unemployment Rate	Mar. 98	4.7	5.2
Interest Rate	Apr. 98	5.58	5.71

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Development and Aid

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Colm Foy, Francis Harrigan, David O'Connor
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Olivier Bouin, Fabrizio Coricelli, Françoise Lemoine
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No. 24
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Providing a Secure Environment for Learning
March 1998
The question of security in schools and universities is becoming a growing concern in many countries. How can violence in both schools and universities be measured and curbed? How should the very notion of security be tackled? Whereas security has to date been mainly analysed in terms of material and legal forms of risks (fire, non-compliance of equipment with safety standards, and so on), this publication shows that the human factor should not be overlooked. The organisation of people's relationships should matter both in the buildings' design and construction stage, and in the management of education. This report synthesises the lessons learned from the Bologna-Florence seminar in May 1997. It examines the key issues of the seminar, namely prevention, protection and partnership, and considers their social and financial implications.
(95 98 01 3 P) ISBN 92-64-05756-0, 84pp., bilingual
FF110 US$19 DM33 £11 ¥2,350

Energy

Nuclear Energy Agency (NEA)

Safety Research Needs for Russian-Designed Reactors
March 1998
The OECD Nuclear Energy Agency co-operates with both the Central and Eastern European Countries and the New Independent States of the former Soviet Union in planning and executing safety research programmes. The purpose is to build up know-how and capabilities in safety technology pertaining to their nuclear power plants. In this report, senior safety experts from Russia and Western countries review the nuclear-safety research needed to improve the safety of Russian-designed nuclear power reactors. They have selected a number of important research topics to which priority should be given. They have also identified nuclear-safety research topics that would benefit from a collaborative effort between eastern and western nuclear-safety research.
(66 98 04 1 P) ISBN 92-64-15669-0, 64pp.
FF80 US$16 DM23 £10 ¥1,700
Also available as an electronic book.

OECD Documents

Overview of Nuclear Legislation in Central and Eastern Europe and the NIS
March 1998
This publication examines the legislation and regulations governing the peaceful uses of nuclear energy in Eastern European countries. It covers eleven countries from Central and Eastern Europe and five countries from the Community of Independent States (Armenia, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Kazakstan, Latvia, Lithuania, Poland, Romania, Russian Federation, Slovenia, Slovak Republic, Ukraine). The chapters follow a systematic format making it easier for the reader to research and compare information. This study will be updated regularly
(66 98 05 1 P) ISBN 92-64-16018-3, 118pp.
FF150 US$25 DM45 £15 ¥3,050

NEA Newsletter Volume 16 1998
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March 1998
(68 98 02 1 P) ISBN 92-64-15969-X
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Environment

Towards Sustainable Development
Environmental Indicators
March 1998
Interest in sustainable development and awareness of the international dimension of environmental problems have stimulated governments to track and chart environmental progress and its links with economic conditions and trends. This publication presents leading environmental indicators from the OECD Core Set and thus contributes to measuring environmental performance and progress towards sustainable development. Organised by issues such as climate change, air pollution, biodiversity, waste or water resources, this book provides essential information for all those interested in sustainable development.
(97 98 03 1 P) ISBN 92-64-16080-9, 130pp.
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Performance and Challenges in OECD Countries
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Also available as an electronic book.

Eco-Efficiency
March 1998
This publication evaluates strategies to improve the efficiency with which environmental resources are used to meet human needs. Many firms in OECD countries have developed strategies that involve: developing goals to reduce resource use and pollutant release while improving customer service; working towards the goals through innovation in technology, practices, and ways of thinking; and designing indicators to monitor progress. Similar approaches have been used outside business, for example by governments, communities and groups of households. Such strategies have achieved improvements in material and energy efficiency in the region of 10 to 40%. The full potential for improving eco-efficiency is much higher, but it is only likely to be achieved through coherent government policies for sustainable development.

This book identifies policies that can encourage innovation by firms and communities, and provide an economy-wide framework of economic and regulatory incentives for the adoption of more sustainable patterns of production and consumption.
(97 98 07 1 P) ISBN 92-64-16085-X, 55pp.
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Towards Sustainable Consumption Patterns
A Progress Report on Member Country Initiatives
March 1998
Addressing unsustainable patterns of consumption is a crucial challenge for OECD member countries in tackling environmental problems. However, measures to influence consumer demand have, in the past, received less attention than measures to influence production patterns. This progress report provides an initial overview of the broad array of policies and policy instruments which OECD member countries are already using or considering to

influence consumer demand for certain goods and services. These include a wide range of regulatory, economic and social policy instruments, as well as other actions by government, such as capital investment and the use of the land-use planning system. Such actions often form part of member countries' strategies to tackle major environmental problems, such as climate change.

This report reviews currently available information on the success of member country initiatives in influencing consumption patterns. It finds that detailed information on the effectiveness of these policies is still limited, partly because many of the measures have only recently been put in place. It also identifies next steps for the OECD and for its member countries, both to improve knowledge of policy initiatives and to take more effective action to influence consumption patterns.

(97 98 08 1 P) ISBN 92-64-16087-6, 55pp.
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Improving the Environment through Reducing Subsidies
Part I: Summary and Conclusions
Part II: Analysis and Overview of Studies

April 1998

(97 98 09 1 P) ISBN 92-64-16091-4, 130pp.
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9th addendum

March 1998

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April 1998

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OECD Proceedings

Water Consumption and Sustainable Water Resources Management

March 1998

(97 98 04 1 P) ISBN 92-64-16082-5, 40pp.
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Globalisation and the Environment
Perspectives from OECD and Dynamic Non-member Economies

March 1998

Globalisation is binding countries into closer economic – and environmental – interdependence through intensified trade and investment linkages and rapid advances in technology. It is also changing the context of environmental management at national, regional and global levels and is creating new challenges to, and opportunities for, the public and private sectors in the transition to sustainable development. This volume contains papers on these subjects by leading experts from OECD member countries, Asia and Latin America. The papers were presented at the OECD Workshop on Globalisation and the Environment: New Challenges to the Public and Private Sectors.

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Financial, Fiscal and Enterprise Affairs

Harmful Tax Competition
An Emerging Global Issue

April 1998

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Financial Market Trends 1998
No. 69

March 1998

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FF135 US$26 DM40 £16 ¥2,900
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OECD Documents

The Taxation of Global Trading of Financial Instruments

March 1998

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FF120 US$20 DM36 £12 ¥2,500
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OECD Proceedings

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March 1998

How can the efficiency of state-owned enterprises be improved? What effects do privatisation policies have on corporate governance in privatised enterprises? What role do employees play in corporate governance?

This publication examines these issues and provides recommendations. It presents the papers of the OECD conference on 'State-Owned Enterprises, Privatisation and Corporate Governance' which took place in Paris on 3 and 4 March 1997. It brings together contributions from different countries highlighting different approaches to governance in state-owned enterprises and the impact of the choice of privatisation method on post-privatisation corporate governance and performance.

Special attention is paid to the experience of Canada, France, New Zealand and the United Kingdom.

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Economies in Transition

OECD Proceedings

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April 1998

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This volume brings together papers from an OECD workshop that assessed the challenges and opportunities of environmental financing in Russia today. Its case studies focus on the regional and local levels of government, which have taken over the main work of implementing environmental policy in Russia today.

The book also looks at the water sector, which has traditionally required large public investments. The papers examine how current financial mechanisms can be used more effectively and consider opportunities for new sources of financing in Russia's current transition to a market economy. Furthermore, they point to key areas for reforming Russia's environmental policy framework.

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Human Capital Investment
An international Comparison

April 1998

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The Role of Profiling

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Across OECD countries, millions of unemployed have been out of work for more than a year. One possible way to combat the drift into long-term unemployment is to offer more assistance to job losers before they reach the stage of long-term unemployment. But it would be very costly to offer in-depth help to all of the job losers. This has led some countries to develop methods to both identify jobseekers at risk of becoming long-term unemployed and refer them to suitable labour-market programmes, usually known as profiling. But is it possible to accurately identify such jobseekers? And if so, what assistance should be offered to them? Is profiling always appropriate? Drawing on the experiences of four OECD countries, Australia, Canada, the United Kingdom and the United States, this publication highlights the key issues involved in profiling. It also presents national reports from each of the four countries which not only reflect different approaches to profiling but also different views on the relevance and reliability of formal profiling methods.

(81 98 04 1 P) ISBN 92-64-16066-3, 119pp.
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Public Management

Public Management Occasional Papers

User Charging for Government Services
Best Practice Guidelines and Case Studies No. 22

March 1998

The Public Management Occasional Papers are specialised reports prepared for the work of the OECD's Public

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Science, Technology and Industry

STI Review 1997 No. 21
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Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets
A Report to the OECD by the Business Sector Advisory Group on Corporate Governance
March 1998
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OECD Proceedings

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Local Management for More Effective Employment Policies
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See Sylvain Giguère, 'The Territorialisation of Employment Policies', **The OECD Observer**, No. 210, February/March 1998.
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Trade

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The Benefits of Trade and Investment Liberalisation
April 1998
See Donald J. Johnston, 'Securing the Benefits of Trade and Investment', **The OECD Observer**, No. 211, April/May 1998.
(22 98 01 1 P) ISBN 92-64-16100-7, 100pp.
FF120 US$20 DM36 £12 ¥2,550

The Export Credit Arrangement 1978/1998
Achievements and Challenges
April 1998
See Steve Cutts and Janet West, 'The Arrangement on Export Credits', **The OECD Observer**, No. 211, April/May 1998.
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Statistical Report on Road Accidents 1993/1994
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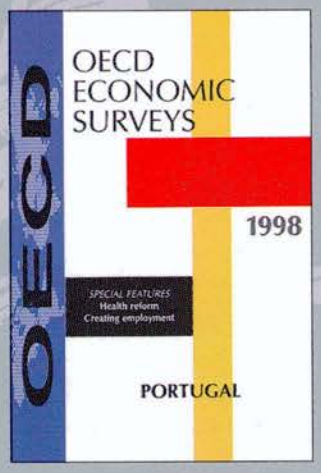

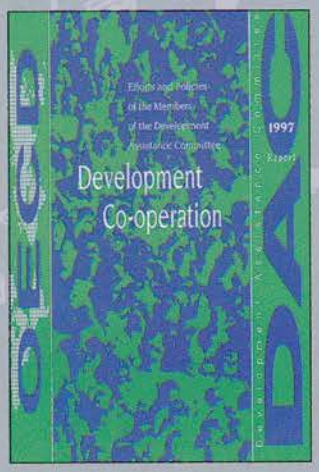

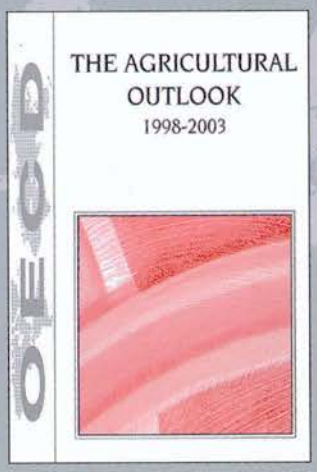

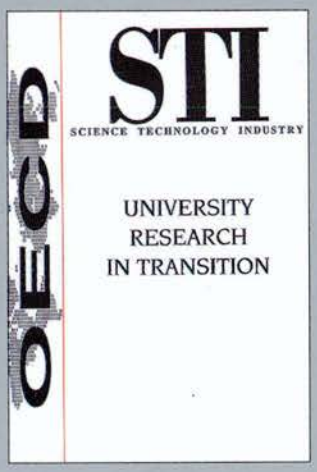

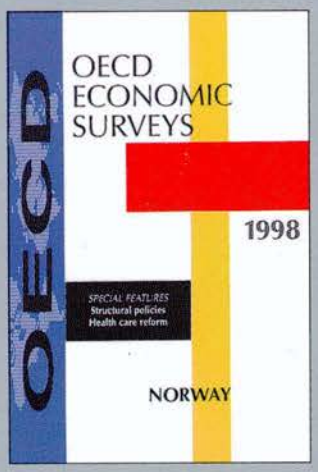

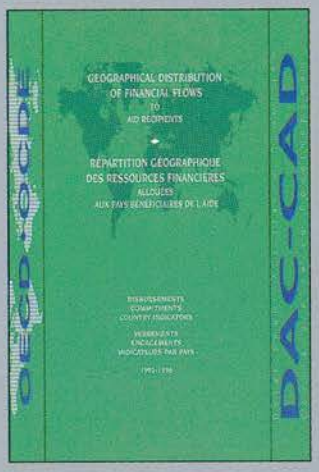

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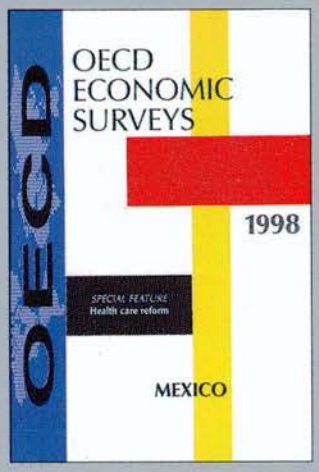

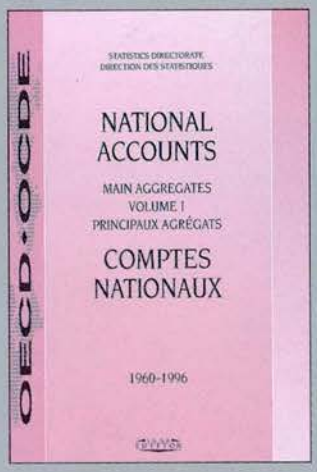

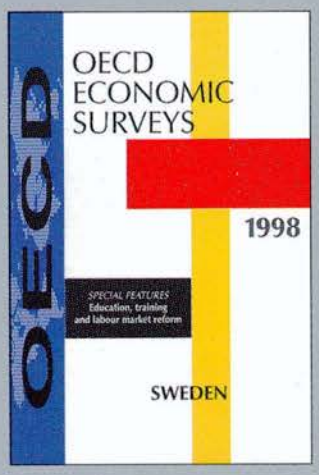

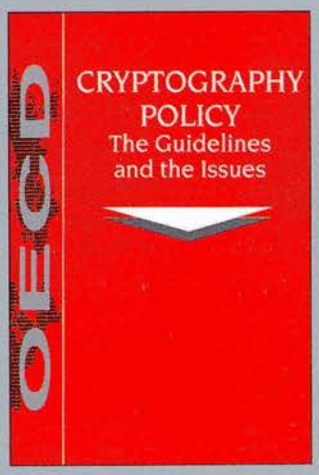

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