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Economic outlook
How fragile?

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Back to the future

As an OECD "veteran", I was delighted to see that "human progress" is now on the OECD agenda (see www.oecd.org/progress). If you compare the OECD strategy to emerge from the oil-shock recessions of the 1970s (the McCracken Report) to the *OECD Strategic Response to the Financial and Economic Crisis* of today, you can see that in three decades the OECD has been transformed.

But I sometimes wonder whether the pace of change has not been so fast that the OECD is losing its organisational memory. If so, this could be a danger to its professional comparative advantage: professional rigour and political impartiality. Take the question of "indicators of progress" raised by the Stiglitz Report. In the 1990s, the OECD undertook a vast exercise on "social indicators" to come to grips with the quality of economic growth. Even "happiness" indicators–a current OECD endeavour of considerable importance–came under scrutiny.

Then there is the wider view of the sources of economic growth necessary to come to grips with the issue of human progress. It may be that "human capital" and "social capital" can now be measured, according to a former chief economic advisor of the OECD, but it should be realised that this is founded on pioneering work on education in the 1960s.

Next, there is the central question of the knowledge economy. Science and technology as a motor of economic growth, but also as a source of ecological and societal risks, has a long history in the OECD. The culminating point was the analysis of the new socio-economic paradigm driven by pervasive technologies, bringing [Joseph] Schumpeter ("creative destruction") and [Nikolai] Kondratiev ("long economic waves") into OECD analysis. None of this would have been possible without statistical indicators of R&D and the technological balance of payments between countries.

Finally, let us not forget either that the Club of Rome was born in the corridors of the OECD!

In a nutshell, the transmutation of quantitative economic growth into human progress is the global challenge ahead. To rise to that challenge, the OECD could draw on a long history of professional analysis.

Ron Gass
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Indian IP

The fundamental blockage to efforts of international agencies like WIPO, OECD, etc. to deal with [intellectual property rights] will be removed only when the private players get into the fray and ask for collective private initiatives ("Counterfeiting and piracy: Fakes, facts and figures", in No 262, July 2007).

As of today such initiatives are severely lacking. In India we have launched a framework called the Integrated Innovation, Knowledge Management and Intellectual Capital Framework (I2KIC Framework), which helps "knowledge" corporations to mature their innovation and IP processes via a three-stepped model. Process-oriented corporations, media, entertainment, animation, gaming and publishing industries are turning to such frameworks to improve their IP. The main impetus of these efforts is to increase awareness and respect for IP, while seeking better valuations in the marketplace. IP Maturity Certifications by I2KIC make them an attractive target for high-technology, IP safe investments. They are helping the industry in the event of a sale or a merger. Similar concepts could be applied and promoted by the OECD.

Ajay Batra, web comment. Contact address available at www.oecdobserver.org

The challenges ahead

Angel Gurría, Secretary-General of the OECD

We have to step up and strengthen our work on development, and address a deepening social and employment crisis

2010 started with the devastating earthquake in Haiti that killed well over 100,000 people and nearly destroyed a country. We stand in solidarity and sympathy with the people of Haiti, whose tragedy brought back memories of the tsunami just before New Year 2004. Nothing can replace the loved ones lost.

If there is a positive side, it is in the massive coming together of people and countries from around the world to help Haiti face the emergency and start rebuilding this poor yet vibrant country. Such co-operation embodies the spirit of the OECD, which is playing its part to help Haiti back on its feet by monitoring emergency aid flows and lending support to ensure adequate planning, coherent policies and effective public investments.

Looking beyond the response to this great tragedy, there are other important tests for the year ahead. The financial storm of 2008-09 may have passed, but the world economy is still leaning against the wind, with fiscal deficits in the OECD area ballooning to around 8% of GDP and a gross public debt likely to outstrip GDP by 2011.

The outlook points to a relatively modest recovery. Bank balance sheets have improved, but lending remains hesitant. Most of the growth in demand will come from public spending, as household and business spending remains weak. Unemployment will peak over 9% and reach double digits in some countries, straining finances and deepening the social crisis. And while world trade has started growing again, it remains below its pre-downturn level. At least inflation will be low, despite firm energy prices.

The crisis has left some scars, and there is much work to do to make the world economy stronger, cleaner and fairer. As I mentioned in my new year's wishes, we can feel proud of our achievements in 2009. But we should not rest on our laurels and have to keep working hard in 2010.

The crisis has worsened prospects for developing countries, where 90 million more people faced poverty last year, and more migrants moved to already overcrowded, vulnerable cities. We have to step up and strengthen our work on development, and we have to address a deepening social and employment crisis in many of our own member countries. With OECD-wide unemployment edging towards 57 million this year, labour activation policies and measures to relieve disparities must be stepped up. Delivering quality yet cost-effective healthcare for all will also pose challenges, and a major meeting of OECD health ministers next October will examine the way forward.

The OECD will also continue to focus on strengthening our anti-bribery instruments and corporate-governance frameworks, developing the ideas we started with the G8 on a "global standard" for market economies and advancing the important international collaborative work to devise new measures of progress for the 21st century.

We will continue to examine the causes of the crisis too, so that governments can prepare their exit strategies for the exceptional measures taken during the crisis. We should also support reforms, particularly in financial markets, where OECD experts show that improving prudential regulation to enhance stability can be compatible with increased competition. Such evidence will help policymakers build the new regulatory environments needed to win back public confidence and bolster growth.

This will also help get finance flowing again to small and medium enterprises, as these are essential pillars driving innovation. The crisis has shown that a different kind of economic growth is needed, and innovation is fundamental to achieving it. The OECD Innovation Strategy, to be presented at the OECD Ministerial Council Meeting in May 2010, will be a timely boost. After all, innovation is vital for the greener recovery we need to help reduce carbon emissions and spur sustainable growth. A key priority at the OECD will be to carry forward our 2009 mandate to develop a green growth strategy for the future.

Halting climate change is vital for this. The agreement reached at the UN climate change conference in Copenhagen last December was far from perfect, and the OECD is working to support international efforts towards a more substantial outcome at the COP16 meeting in Mexico later this year.

The OECD is delighted to enter 2010 reinforced by the arrival of a new member, with Chile set to become the 31st OECD country, having signed an accession agreement on 11 January. Chile's participation will enrich our work and our voice on the global stage. In the months ahead we will continue accession talks with four other candidate countries and pursue our enhanced engagement strategy with key emerging economies. Building a more diverse, dynamic and relevant organisation is the right way to begin celebrating our 50th anniversary, starting in December 2010.

By working together to address tough challenges, we can make a difference in 2010.

www.oecd.org/secretarygeneral
www.oecdobserver.org/angelgurria

News brief

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OECD Secretary-General Angel Gurría (left), Chilean President Michelle Bachelet and Finance Minister Andrés Velasco at the accession ceremony in Santiago, 11 January 2010

A new member and a milestone

Chile will become the OECD's 31st member–and its first in South America–under an accession agreement signed on 11 January 2010 in Santiago by OECD Secretary-General Angel Gurría and Chilean Finance Minister Andrés Velasco. Chile will formally become a member of the OECD in March, once its parliament has ratified the accession agreement.

President Michelle Bachelet hailed her country's accession to the OECD as "the start of a new road towards the future that opens new and great opportunities to advance more rapidly'" towards the ranks of the world's developed countries. For the OECD, Chile's membership is a major milestone in its mission to build a stronger, cleaner and fairer global economy. "The 'Chilean way' and its expertise will enrich the OECD on key policy issues," said Mr Gurría during a signing ceremony in Santiago. "Chile has been engaged in a continuous effort to reform its economy."

The Chilean economy has been growing at over 5% a year for the last 20 years. Chile's groundbreaking pension reforms in the early 1980s have served as a model for many other countries, and when the financial crisis hit in 2008, Chile's prudent tax policies gave it the financial leeway needed for stimulus measures to support demand and employment.

See speeches on page 38.
For more, see www.oecd.org/chile

Lighter tax burdens

The recession is taking its toll on **tax receipts** across the OECD. Aggregate tax burdens in OECD economies were unchanged between 2006 and 2007, but fell in 2008. The reduction in the tax burden, which is a ratio of tax revenues to GDP, was estimated at about 0.5% of GDP, from 35.8% to 35.2%. Tax burdens are also likely to have fallen further in 2009. Tax receipts often fall proportionately more than GDP in a recession, but this time many OECD countries also cut taxes in late 2008 and early 2009 to bolster their economies in the financial crisis. **See www.oecd.org/tax**

Soundbites

On finance...
"It sounds to me a little bit like selling a car with faulty brakes and then buying an insurance policy on the buyer of those cars."
Phil Angelides, chair of the Financial Crisis Inquiry Commission in the US, reacting to the explanation by Goldman Sachs's chairman, Lloyd C. Blankfein, on how his firm sold bundles of troubled mortgages while placing bets with Goldman's own money that their value would fall, quoted in *The New York Times*, 14 January 2010.

"Do bankers really think they can win a debate about fairness?"
David Wessel, in *The Wall Street Journal*, 21 January 2010.

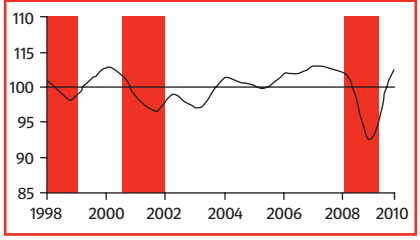
"The most boring bank in the world"
Time magazine headline about prudence at Spanish bank Santander, which emerged from the crisis relatively unscathed, 18 January 2010.

...and multilateralism
"Copenhagen is but the most recent reminder that classic multilateralism is increasingly difficult to achieve."
Richard Haass, president of the Council on Foreign Relations, writing in the *Financial Times*, 6 January 2010.

Economy

Early signals of recovery have strengthened, according to the latest composite **leading indicators**. Covering such measures as order books, building permits and long-term interest rates, the leading indicators for the

Leading indicators point up, OECD area



Haiti

Secretary-General Angel Gurría offered the OECD's "experience and know-how" as part of international efforts to rebuild Haiti after it was struck by a devastating earthquake in mid-January that left more than 100,000 people dead and more than a million without shelter. "We will...be working with the donor community to promote efficient and principled humanitarian assistance, both in the short-term relief effort and in the longer-term challenge of reconstruction and development," he said. "But we understand that nothing can replace the loved ones lost or repair the lives and memories scarred for life." See editorial on page 3, and for the full statement, visit **www.oecd.org/speeches**. See also **www.oecd.org/dac**

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OECD area and the US increased by one point each in November 2009. The euro area's indicators increased by 1.1 point in November, up by 10.9 points year-on-year, while the indicators for Japan grew by 1.2 points, 5.4 points higher than a year ago. The outlook is similar in non-member economies.

Merchandise **trade** volumes of the G7 countries grew in the third quarter of 2009 after stabilising in the second, but were well below 2008 levels. Year-on-year, exports were down 17.5% while imports were 14.6% lower.

Consumer prices in the OECD area rose by 1.3% in the year to November 2009, compared with a rise of 0.2% in October 2009. Consumer prices for energy rose by 2.4% in the year to November, following a fall of 9.2% in October.

Unemployment in the OECD area was 8.8% in November 2009, the same as the previous month and 2.1 percentage points higher than a year earlier. In the euro area, it reached 10% in November 2009, the same as the US unemployment rate for December 2009. For Japan, unemployment was 5.2% in November, 1.2 percentage points higher than a year earlier. **For more, go to www.oecd.org/statistics**

Investment notes

International **mergers and acquisitions** are forecast to decline by 56% in 2009 compared with 2008, the largest year-on-year decline since 1995. While the fall is largely due to the 60% drop in value of cross-border mergers and acquisitions (M&A) by firms based in the OECD area, the first sharp declines in M&A activity into and from major emerging economies, such as Brazil, China, India, Indonesia, Russia, and South Africa contributed to the steep fall. For more, see Databank, page 77.

Morocco has joined 41 other countries in signing the OECD Declaration on International Investment and Multinational Enterprises. In doing so, Morocco agrees to treat foreign investors in the same way as domestic investors and to promote responsible business conduct. Moroccan investors abroad will receive similar equitable treatment in other signatory countries, which include all OECD members and several non-OECD countries. Morocco signed the Declaration at the MENA-OECD Ministerial Conference in Marrakech in November 2009. For more on the conference, see page 39, and *OECD Observer* No 275, November 2009, available at **www.oecdobserver.org**

Aid and climate change

Financing mitigation efforts in developing countries was a notable feature of the Copenhagen Accord on climate change in December. As of the beginning of 2010, members of the OECD Development Assistance Committee will not only track development aid according to whether it will help fight climate change, but also according to whether it will help humans and natural systems to maintain or improve their resilience to it. **For more, visit www.oecd.org/dac**

New chief economist

©David Sterboul/OECD.

Pier Carlo Padoan, deputy secretary-general of the OECD since 2007, has been appointed chief economist of the OECD. A former professor of economics and advisor to the Italian prime minister, Mr Padoan also served at the International Monetary Fund from 2001 to 2005. Mr Padoan will continue in his role as deputy secretary-general.

Is financial stability enough?

William R White, Chair of the OECD Economic and Development Review Committee

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As regulators and policymakers continue to examine new rules for the financial services, stock markets are booming and bank bonuses are being paid out anew. A happy new year, or should we be worried that, without corrective action, another financial crisis could strike in the months or years ahead?

Since the late 1990s, financial stability issues have received increasing attention. The Asian crisis of 1997, the failure of the LTCM hedge fund in 1998, and the global downturn at the end of the 1990s all involved dangerous amounts of speculation and threats to the efficient functioning of financial markets. As a result, many central banks set up separate financial stability departments, Financial Stability Reports proliferated, and the activities of the Financial Stability Forum received increasing attention.

The current crisis has further sharpened the policy focus on financial safeguards. This is not surprising. It is commonly believed that the crisis had its origins in the market for sub-prime mortgages in the United States and then spread globally via such other financial markets as those for asset-backed securities. Further, the extraordinary efforts made by governments to liquefy financial markets again and to recapitalise financial institutions continue to dominate headlines and affect perceptions about underlying causes. The recently upgraded status of the Financial Stability Board by international political leaders and the extension of its membership to include all G20 countries attest to the fact that financial issues are being treated ever more seriously.

> It seems clear that, during the boom, there was a buildup of excess global capacity in a whole range of industries

And so they should be, since a well-functioning financial system is a necessary condition for a vibrant market-driven economy. Without an adequate system for allocating savings and ensuring payments, economic progress is likely to be limited. This has been the rationale for public sector interventions to regulate and otherwise support the banking system for a century or more.

However, the proliferation of financial markets and the relative decline of intermediated credit in recent years have turned the focus to underlying systemic questions. Indeed, we now know that surface indicators of good financial health can be seriously misleading. If market participants are hit by the same shocks, are similarly vulnerable and react similarly as well, the implications for the financial system as a whole and the real economy it underpins can be devastating.

So, financial stability is necessary. However, similar to the earlier failure of price stability to deliver macroeconomic stability, financial stability is also not sufficient to achieve that objective. While "booms" similar to the one we had lived through since the 1990s are ultimately driven by an excess of credit, the imbalances to which they give rise go well beyond unjustified asset price increases and a potentially weakened financial sector. One particular contributor to the severity of the "bust" is debt. In fact, in Japan through the 1990s and beyond, it was not the weakened banking sector that forestalled recovery, but the efforts of the Japanese corporate sector to reduce debt after the excesses of the 1980s. A similar challenge may now be in store for the US, UK and a number of other countries, as consumers and businesses reflect on the state of their balance sheets.

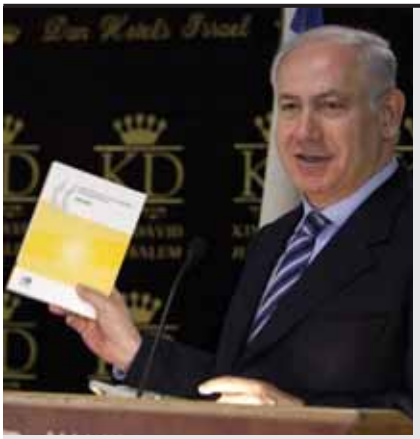
But even this broader set of balance-sheet effects fails to account fully for the imbalances generated by excessive credit growth. Perhaps most important is a misallocation of real resources, which then weighs heavily on the economy during the subsequent downturn. In a number of economies, not least the US, the combination of consumption and housing investment rose to unprecedented levels as a proportion of GDP. In China, there was a corresponding upsurge in capital investment. These two developments combined suggest that Asia is now all geared up to produce export goods that the traditional purchasers can no longer afford to buy. And to add to the difficulties ahead, it seems clear that, during the boom, there was a buildup of excess global capacity in a whole range of industries–cars and trucks, banking, wholesale distribution, construction and steel, among many others.

It will take a significant amount of time for the underlying resources (labour and

capital) to be either written off or shifted into more profitable and sustainable endeavours. During that time, aggregate production potential will be diminished and structural unemployment will rise. Credit-driven "boom and bust" cycles touch all parts of the economy. This has institutional implications. If the problem extends well beyond the stability of the financial sector, then oversight and prevention should more appropriately be entrusted to those used to thinking in macroeconomic terms.

In current circumstances this probably means central banks rather than traditional financial sector regulators, although the latter would clearly have an important role to play as well. Indeed, there seems to be a growing consensus that regulatory instruments–like countercyclical capital requirements and provisioning–could directly mitigate the tendency to excessive credit increases and financial leverage during cyclical upswings. However, this consensus should not preclude the complementary use of monetary policy as well. Low interest rates encourage borrowing for risk-taking in the search for higher returns, and feed speculation and leverage in turn. Indeed, given the high economic costs associated with these cycles and the known shortcomings of both regulatory and monetary policies, a judicious combination of all instruments of control at our disposal would seem a perfectly sensible strategy.

The increasing recognition that credit cycles have implications for both the demand side and the supply side of the global economy reveals an important role for the OECD. The organisation has spent decades working on structural issues and how demand and supply side forces interact. These analytical insights are now helping the OECD to make a material contribution to two of the most important policy issues of our time, issues being debated in the G20 and elsewhere. How can we best get out of the current crisis, and how can we prevent or mitigate the effects of such crises in the future?



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Israel's prime minister, Benjamin Netanyahu, holds up an OECD report

Israel's economy

More active education and employment policies, particularly targeted at minority groups, are needed to bolster its economic performance and bridge deep divisions within its society.

These are key conclusions of an OECD *Review of Israel's Labour Market and Social Policies* and an *OECD Economic Survey of Israel*, which were issued in the context of negotiations for Israel to become a member of the OECD. Israel's economy has weathered the crisis, with GDP growth in 2009 of around 0.5%, above earlier projections.

But there are weaknesses to address, particularly on the social welfare side. One in five Israelis lives in poverty, a higher ratio than in any OECD country, according to the *OECD Review of Israel's Labour Market and Social Policies*. Poverty is highest among the youngest and fastest growing population groups: just over half of Arab Israelis and 60% of Haredim, or ultra-Orthodox Jews, have disposable income that is less than half the national median, compared with just over 10% of the rest of the population. This reflects low employment levels, particularly among Arab women and Haredi men, and low basic support for pensioners. Most low-paid jobs with little security are filled by Arabs, Haredim and foreign workers.

At the equivalent of 16% of gross domestic product, public spending on social policies in Israel is low in comparison with the average for OECD countries of 21%, and getting more people from under-represented groups into employment will require increased public spending.

To achieve these objectives, the OECD recommends investing more in active labour market policies and in making it worthwhile for low-skilled workers to take jobs. It calls for action to promote fair employment opportunities for minorities in both the public and private sectors and to enforce labour laws and minimum employment conditions more effectively.

On the education front, the OECD urges action to reduce the inequalities faced by Arab Israelis and calls for efforts to encourage the Haredim to strengthen their vocational skills.

The OECD's economic survey is also critical of the Bank of Israel's intervention in foreign-currency markets and the finance ministry's direct supervision of some financial markets. The survey emphasises that while there are legitimate calls for increased spending, such as in social policy, the Israeli authorities should nevertheless reduce the burden of public debt, and it stresses the need to cut back on areas of public spending that are the least effective.

The report also makes several recommendations on taxation, urging caution in pursuing further corporate and personal income tax cuts and advises the elimination of low-priority tax expenditures.

Visit www.oecd.org/israel

What banks actually do

As the financial storm recedes the full cost of the damage is being assessed. According to *Financial Market Trends*, from the start of the crisis to October 2009 governments and central banks in the US and Europe had provided over $11 trillion in support to banks and other financial firms, made up of capital injections, asset purchases, debt guarantees and facilities, and so on. This total does not take account of other wider social and economic costs incurred by way of losses in business, jobs and other fallout from the crisis. Still, as a Dow Jones journalist pointed out in seeing the figures, it amounts to a contribution of over $1,600 for every person on the planet.

The question is: are policymakers doing enough to tackle the root of the problem and prevent the worst crisis in 50 years from happening again?

The authors of one paper in *Financial Market Trends* would like to see more attention being paid to underlying structures. Indeed, the OECD has argued for structural separation of commercial and investment banking functions for 18 months, in numerous publications including the material submitted by the secretary-general to the London G20 summit. Previous papers and books have set out the best legal structure to achieve separation. This latest piece explains why separation is an essential complement to a leverage ratio in the case of large (too-big-to-fail) conglomerates. Since its publication, the Obama administration has come out with a similar idea–for structural separation–referred to as the Volcker plan. The political ground is shifting in the direction of the separation approach, though for the OECD authors, more governments need to act.

"The world outside of policy making is waiting for a fundamental reassessment of what banks are supposed to do and how they compete with each other. It is the 'elephant in the room' on which some policy makers have not yet had the time or inclination to focus."

They cite a well-respected fund manager, writing in a quarterly letter to clients, who was worried that "by working to mitigate the pain of the next catastrophe, we allow ourselves to downplay the real causes of the disaster and thereby invite another one."

Is there a solution? Is there a better way to prevent volatile investment banking functions from affecting the future stability of the commercial banking and financial intermediation environment that underpin economic activity?

The authors believe there is, via rules on leverage and on the structures of large conglomerates. They point to examples such as Santander, a bank that fully participates in commercial banking and the structuring of products, but in a well-balanced and risk-controlled way. By looking at banking structures and how banks compete, both in the too-big-to-fail category of banks and financial

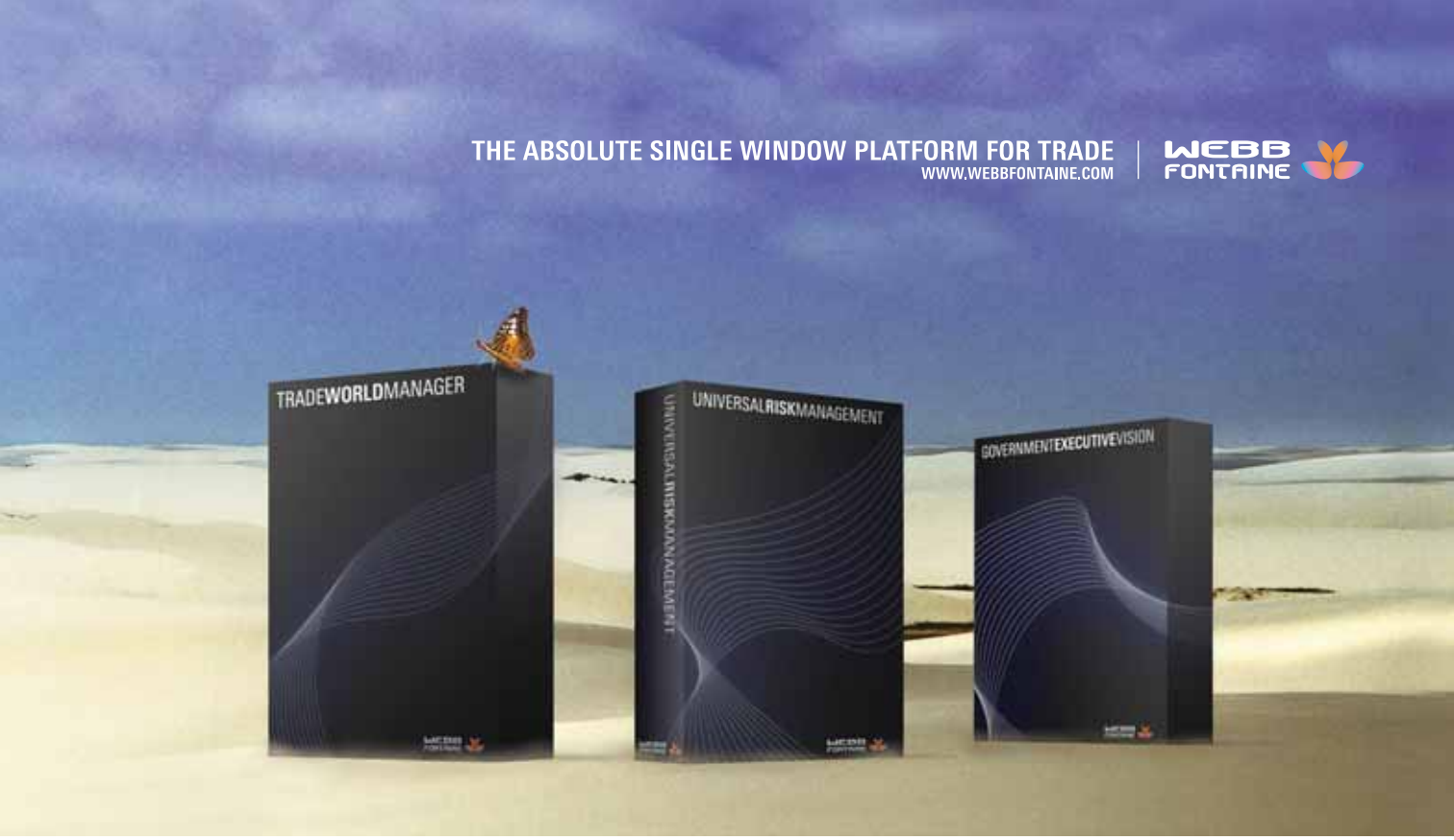
firms on the one hand, and in the hundreds of small regional banks focused on mortgages that have failed and are being merged or closed on the other, the authors describe how the "equity culture" in banking dominated the "credit culture" in what firms actually do.

They assess in detail a range of possible reforms in accounting, corporate governance, and capital adequacy rules, though none of these get to the heart of what banks actually do and so would probably not be enough to prevent a crisis from recurring. The authors recommend combining a leverage ratio to reduce risk at group level with new non-operating holding company structures to reduce contagion. Such a structure allows separation as far as prudential risk and the use of capital are concerned while still permitting synergies and economies of scale. Basically, the non-operating parent could raise capital on the stock exchange and invest it transparently. Its banking subsidiaries would be separate legal entities with their own governance and would pay dividends through the parent to shareholders out of profits. Contagion is reduced in part because the non-operating parent would have no legal basis to shift capital between affiliates in a crisis.

In short, because revising ownership structures deals with root problems, it would steady the ship and confidence would return as a result. With fiscal policy stretched and joblessness rising, most taxpayers would probably support that.

Blundell-Wignall, Adrian, Gert Wehinger and Patrick Slovik (2009), "The Elephant in the Room: The Need to Deal with What Banks Do", in *Financial Market Trends*, October.

Hannon, Paul (2009), "OECD: Global Government Support For Financial System $11.4 Trillion", on *Dow Jones Newswires*, 13 January.



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Climate change: No cop out

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At Copenhagen world leaders moved forward in step on climate change. More progress is needed in the year ahead.

No matter how firm the scientific evidence may be, confronting the climate change problem globally and effectively remains a challenge.

After weeks of negotiating and uncertainty about who would be on board, an 11th hour agreement dubbed the Copenhagen Accord was finally drawn up on 18 December by a limited group of leading countries, and the next day the Conference of the Parties to the UN Framework Convention on Climate Change (COP15) took note of the accord.

No-one doubted that solving climate change would be difficult, economically and politically, and for many in civil society, business and policy circles, the outcome of the conference fell short of expectations. But in the circumstances there was also some relief, and even satisfaction, that an agreement was finally reached. In the words of the Danish prime minister and conference chair, Lars Løkke Rasmussen, "we have achieved a result."

Having heads of state and government from the world's largest emitters gather in a room and acknowledge that "deep cuts in global emissions are required" and the need for countries to "co-operate in achieving the peaking of global and national emissions as soon as possible", bearing in mind priorities such as development and poverty eradication, sent a serious signal. "Though far from perfect, the Copenhagen Accord is a hard-fought political agreement," said OECD Secretary-General Angel Gurría after the conference. "With most countries likely to sign, it is a breakthrough towards collective international action to limit global emissions and help build cleaner, more resilient economies."

The accord's package of measures was agreed by leaders of both the largest emitting countries and small vulnerable states who together expressed a "strong political will to urgently combat climate change in accordance with the principle of

common but differentiated responsibilities and respective capabilities." The ultimate objective is to "stabilise greenhouse gas concentration in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system", which the agreement recognises as holding the increase in global temperature at "below 2 degrees Celsius".

> The OECD is supporting international efforts towards a successful outcome at COP16 in Mexico

Various approaches to mitigate climate change are to be used, including market opportunities to enhance the cost-effectiveness of mitigating action. The accord recognises the need to tackle deforestation and agrees to establish a Copenhagen Green Climate Fund to mobilise financing and a high-level panel to study the contribution of potential sources of revenue, including alternative funding, towards meeting the finance goals. New financing to help developing countries to address climate change more generally was a notable feature of the agreement, with developed countries committing to "a goal of mobilising jointly US$100 billion a year by 2020 to address the needs of developing countries" and "to provide new and additional resources, including forestry and investments through international institutions, approaching US$30 billion for the period 2010-2012", with least developed countries, small island developing states and Africa being the priorities.

An assessment of the implementation of the accord to be completed by 2015 is called for. For this to happen, many experts say more clarity will be needed on the likes of targets, market mechanisms and measuring, reporting and verifying progress. Policymakers, business and civil society will be working together to fill in these gaps in the run-up to the next climate change conference in Mexico later in 2010. The OECD is supporting international efforts towards a substantial outcome at that meeting. "We look forward to working with Mexico and the broader international community, ideally to establish a legally-binding agreement for post-2012 action," Secretary-General Gurría said, warning that to "achieve this agreement, international organisations have a major role to play by informing the discussions and helping negotiating parties reach a common understanding of the issues at stake."

Take the issue of targets for reducing greenhouse gas emissions. OECD analysis suggests that under the targets declared up until Copenhagen, developed countries would reduce emissions by only 18% in 2020 compared with 1990 levels, which is below the 25-40% reduction needed to stay within a 2°C temperature increase according to the scientists.

Developing countries also need to go further, and the OECD is working to help both developed and developing countries identify where they can step-up reductions, while still allowing the economy to grow. This also means greater analysis of how to adapt to climate change in all areas of economic development, and focusing on ways to assist developing countries to manage the risks and become more resilient to possible impacts of climate change.

On financing, the OECD is exploring ways for governments to ensure that their domestic policy frameworks set the right price for carbon and send the right signal to private investors. For instance, if developed countries reduced their emissions by 20% by 2020, based on a mix of policies that included instruments such as taxes and trading markets that put a price on carbon, they could raise the equivalent of 2.5% of their GDP. A fraction of that amount would be enough to supply the public money they agreed to provide in Copenhagen.

All these steps matter, reinforcing other areas policymakers must encourage, such as better access to technological innovations, more consumer and industry information, and more effort in adaptation.

While the outcome of Copenhagen did not deliver the certainty that many people had hoped for, declarations of targets and actions that both developed and developing countries have already made under the Copenhagen Accord indicate that COP15 did at least secure an important step in the right direction. The challenge the global community now faces is to deliver on country pledges for mitigation action by 2020. That means world leaders must step up to the plate and deliver climate finance, and agree on a broad post-2012 climate framework. The task will not be easy, but it is achievable, and necessary for a sustainable future. That should be enough to drive everyone forward on the road to COP16 in Mexico later this year. ■ *RJC*

Download the Copenhagen Accord at www.en.cop15.dk

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After Copenhagen: The European business perspective

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Philippe de Buck,
Director General of BUSINESSEUROPE

European businesses were disappointed with the climate change agreement hammered out in Copenhagen. Here's one way forward.

BUSINESSEUROPE was disappointed by the limited outcome of the Copenhagen conference on climate change. The national commitments likely to be attached to it by the end of January look insufficient to tackle climate challenge globally. European companies will have to face competitive distortions at the international level for a long time to come. While we are committed to developing new, low-carbon technologies and processes, it will be much harder to carry out the necessary investments without the certainty that clear, ambitious and equivalent greenhouse gas-reduction targets provide.

There are positive elements in the Copenhagen Accord. For example, the agreement creates key mechanisms on climate change adaptation, deforestation and technology transfer. The "Copenhagen Green Climate Fund" will manage a considerable amount of money, according to the general commitments made by the signatories, and the concrete pledges for 2010 to 2012 made by the US, Japan and the EU. But the institutional and political modalities of this fund are not clear at all. All the new mechanisms now have to be quickly given substance if we want to make real progress towards a truly global agreement. The EU's conditional commitment to move from 20% to 30% emission reductions did not trigger meaningful further commitments from other countries. They were focusing their negotiations on the framework for a future international climate regime, while the EU was discussing figures.

Climate policy action will continue in 2010, not only within the UN Framework Convention on Climate Change culminating in COP16 in Mexico City in November, but also in the G20, the Major Economies Forum and other international bodies. In these continuing negotiations, a number of policy issues are key for European companies.

The ultimate aim of our efforts must be a global price on greenhouse gases across all countries and sectors, because only this will ensure an economically viable transformation of the world into a low-carbon society.

Equivalence: All developed countries must commit to binding emission-reduction targets that are equally strong in terms of quantitative reductions and the necessary financial efforts. In that respect, the evolution of the draft climate bill in the US Congress this year will be of utmost importance. On the domestic side, we call on the EU institutions not to further increase the 20% emission target until we are clear that other major economies have made more substantial and binding commitments. The EU should work with international partners to ensure that pledges to the Copenhagen Accord are as strong as possible and to fully analyse these national pledges once they are appended.

Competitiveness: Sound international competition for industry needs to be safeguarded at the global level. A process must be started so that industrial sectors exposed to international competition have equivalent obligations. Without a global level playing field, Europe should continue to give an adequate amount of free allowances to trade- and carbon-intensive industry sectors under the EU Emission Trading Scheme (ETS). The EU sticks to the emission-reduction target set for industry under the ETS, namely a 21% reduction from 2005 to 2020. Otherwise, unilateral EU action will lead to carbon leakage, i.e. fewer jobs in Europe and more emissions everywhere.

Actions in developing countries: As agreed under UNFCCC, countries have to act in line with the principles of common–but differentiated–climate-protection responsibilities and action based on respective capabilities. Advanced developing countries like China and India must commit to setting their own binding emission targets or policies so that global emissions peak by 2020 at the latest.

Transparency: All countries, except the least developed countries, must establish a strong, universal monitoring, reporting and verification regime for all major economic sectors, including land-use and forestation. A small first step towards this end was made during the Copenhagen conference, when developing countries agreed to regularly publish their domestic mitigation action according to international guidelines and to have those actions that require international support independently monitored. It is essential to build on this. An enforceable and strong sanction mechanism for non-compliance with reduction commitments must also be established.

Intellectual property rights: Technology dissemination must be promoted by creating enhanced national and regional enabling environments involving the private sector while protecting intellectual property rights. The "Technology Mechanism" created in the Copenhagen Accord must be substantiated in that spirit.

Market-based finance mechanisms: Like the Kyoto Protocol's Clean Development Mechanism, these provide incentives to business to invest in emission reductions within developing countries, and must be strengthened. Companies need certainty as soon as possible about the future of these mechanisms after the first commitment phase of the Kyoto Protocol ends in 2012.

These views are those of BUSINESSEUROPE.

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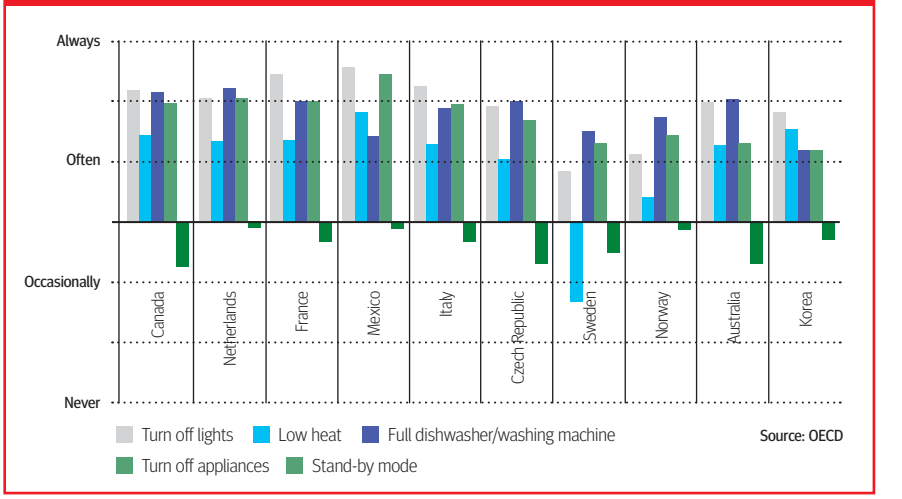
Saving energy

Environmental policies can change people's daily habits, as a new OECD survey shows.

Did you know that Norwegians are more likely to have invested in solar panels and wind turbines than other OECD countries? Or that the Dutch are the most likely to turn off their electrical appliances, rather than leave them on standby? These are just two of the findings that emerge in an illuminating OECD survey of people's behaviour towards the environment in 10 OECD countries and five areas, including energy. The survey was based on more than 10,000 responses gathered in 2008. As the survey suggests, environmental policies do make a difference.

1. Energy-saving habits

Mean response, scale between theoretical minimum ("never" for all respondents) and theoretical maximum ("always" for all respondents)



Source: OECD

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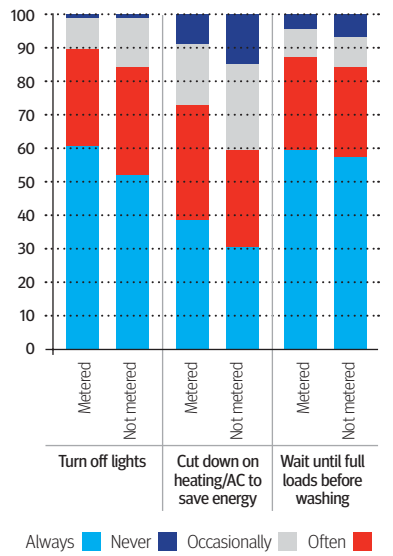
2. Meter effect

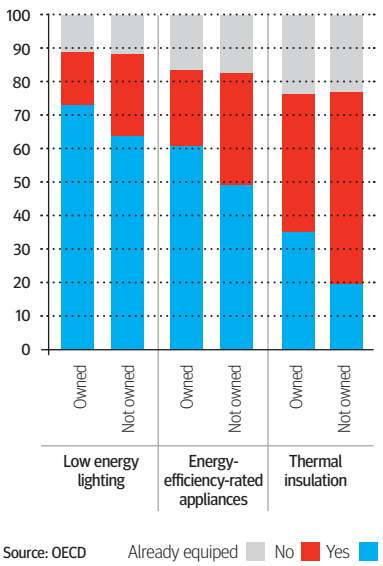
Personal habits depending on whether electricity use is metered or not metered, 2008



Source: OECD

3. Home installations

Energy-saving equipment installed over the past 10 years, according to whether home is owned or not owned, 2008



Source: OECD

Governments have introduced a wide variety of initiatives to improve energy efficiency and develop the use of renewable energy to tackle climate change, including providing grants to firms and households for installing renewable energy appliances, encouraging consumers to reduce stand-by power and phasing out incandescent light bulbs. While the survey shows that those who say they are concerned about the environment are taking action, it also shows that other people will change their behaviour too if given the right incentives and information.

Take energy charges (Graph 2). Results confirm that these work, since respondents paying charges are more likely to save energy, whether by adopting energy-saving behaviour, such as turning off lights or investing in appliances rated high in energy efficiency. Pricing policies are key to encouraging people to save energy.

Homeowners are more likely than tenants to invest in energy-saving equipment and renewable energy technologies (Graph 3). People who own their houses are more likely to have invested in thermal insulation or efficient heating boilers, for example, over the past 10 years than those who do not own their homes. This is largely because they are able to recover the costs of their investment. This has several possible policy implications; for instance, landlords could be given incentives to "green" their rental properties, and tenants could be given the right to recover from their landlords the cost of making such improvements. While the French are most likely to have received support for installing thermal insulation and renewable energy technologies, few respondents in all the countries surveyed report having received government assistance for those investments.

Just under 20% of households report that they "take special measures to buy renewable energy from their service providers". The Netherlands and Korea report the highest percentages of respondents who opt to buy renewable energy from their electricity companies, while in countries with a large ratio of hydroelectric energy in their standard fuel mix, such as Canada and Norway, those percentages are much lower. The survey also shows that almost half of all respondents are not willing to pay too much more to use green energy. Almost 50% of households were not willing to pay any premium to use renewable energy; in a few countries, only 25% of respondents say they would pay more than 5% above their current electricity bill to use green energy.

More survey results are available at www.oecd.org/environment/households. For more information, contact Ysé.Serret@oecd.org or Nick.Johnstone@oecd.org

US health spending: A closer look

Mark Pearson, Head of Health Division, OECD Directorate for Employment, Labour and Social Affairs

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The United States spent 16% of its national income (GDP) on health in 2007. This is by far the highest share in the OECD and more than seven percentage points higher than the average of 8.9% in OECD countries. Even France, Switzerland and Germany, the countries which, apart from the United States, spend the greatest proportion of national income on health, spent over 5 percentage points of GDP less: respectively 11.0%, 10.8% and 10.4% of their GDP.

However, almost all OECD countries, with the exception of the US and the middle-income countries, Mexico and Turkey, have full insurance coverage of their population. Americans consumed $7,290 of health services per person in 2007, almost two-and-a-half times more than the OECD average of just under $3,000 (adjusted for the differences in price levels in different countries). Norway and Switzerland spent around $4,500 per person. Americans spend more than twice as much as relatively rich European countries such as France, Germany and the United Kingdom.

One factor which cannot explain why the US spends more than other countries is population aging. Many European countries and Japan have been aging much more rapidly than the United States. Similarly, Americans are not any more likely to be sick than Europeans or Japanese people, though the very high rates of overweight and obesity are already costly and will drive health spending higher in the coming decades. Americans have had much lower rates of smoking than most other OECD countries since 1980, and so this should be contributing to better health outcomes. Health expenditure can be broken down into different categories of spending:

- In-patient spending is higher than in other OECD countries, but not by as much as might be expected, given differences in GDP.
- Out-patient care spending is also highest in the United States, being more than three-times greater than in France, Germany and Japan, and growing very rapidly indeed. The growth rate is high in other countries as well, but from a lower basis.
- Administrative costs are high.
- Pharmaceutical spending is higher in the US than in any other country, but it accounts for a smaller share of total health spending than in other countries.
- Long-term care spending is a little higher than in other countries, but proportionally accounts for less spending than elsewhere.

The stand-out difference in spending in the United States compared with other OECD countries is in elective interventions on a same-day basis. These accounted for a quarter of the growth in US health spending between 2003 and 2006, compared with just 4% of the growth in Canadian spending. Such services are an important innovation in healthcare delivery, often being preferred, when possible, by patients to staying overnight in a hospital.

Remuneration of US GPs exceeds those of doctors in other countries (being $25,000 to $40,000 more than in UK, Germany and Canada, and $60,000 more than in France, though the data is old, coming from 2003-05). The gap was even larger for specialists. Income levels reflect both fees and activity–physicians are often remunerated on a fee-for-service basis, so the high rates of income of US doctors might reflect both higher fees and higher activity than in other countries. On balance, however, it seems likely that at least some part of the high rates of remuneration are due to high prices rather than to high volume of activity.

Another component of out-patient care costs that has grown rapidly in the United States in recent years is the cost related to diagnostic tests, such as medical resonance imaging (MRI) scans and computed tomography (CT) scans. Billions of dollars are now spent each year on such tests in the United States.

Some studies have attempted to assess the medical benefits of the substantial increase in MRI and CT exams in the United States but found no conclusive evidence.

This is an extract from a written statement submitted by Mark Pearson to the US Senate's Special Committee on Aging in September 2009. The full 2,500 word statement is available online at www.oecd.org/health and at www.oecdobserver.org/healthcare

Health ministerial note

Coming up in 2010!

Health system priorities in the aftermath of the crisis. Ministerial conference, OECD Paris, 7-8 October 2010.

- Health system priorities: Gaining value for money in a crisis while upholding equity, access, quality
- Choices and prevention: Investing in prevention programmes and generating long-term returns
- Public forum on Quality Care: Measuring quality to improve performance. Open to stakeholders.

Contact Mark.Pearson@OECD.org

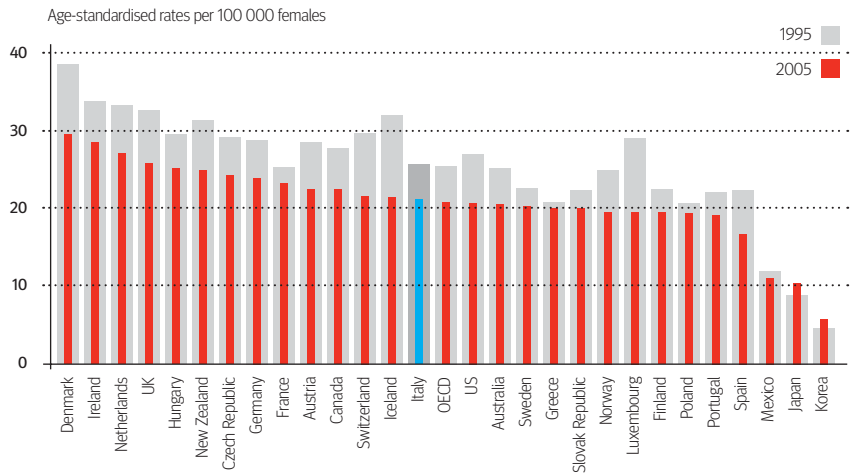
Screening challenge

One in nine women are diagnosed with breast cancer at some point in their life and one in thirty die from the disease. Though survival rates are improving, due to a combination of increased awareness, earlier diagnosis and better treatments with innovative drugs, there are considerable differences in measured outcomes of cancer control across OECD countries. For example, while close to 90% of women aged 50-69 are screened annually in the Netherlands and Finland, only around 20% of women in that age group are screened in the Slovak Republic and Japan. Some countries that had low screening rates in 2000, such as the Czech and Slovak Republics, showed sharp increases by 2006, whereas some countries with already high rates, such as the US, Finland and Norway, reported declines.

While Korea and Japan are the exceptions to the general decline in breast cancer mortality rates in OECD countries, the increases are small and their mortality levels continue to be the lowest among OECD countries. The disparities in mortality and survival rates across OECD countries suggest there is room for more analysis and understanding about this disease. As with all cancers, the causes and approaches surrounding breast cancer are varied and complex. The OECD is engaged in a dedicated project on cancer care more broadly whose preliminary results will be released in 2010 before the October health ministerial.

Breast cancer mortality

Females, 1995 to 2005, or nearest available year



Rates for Iceland and Luxembourg are based on a three-year average.

Source: OECD Health Data 2009. Mortality data extracted from WHO Mortality Database and age standardised to the 1980 OECD population.

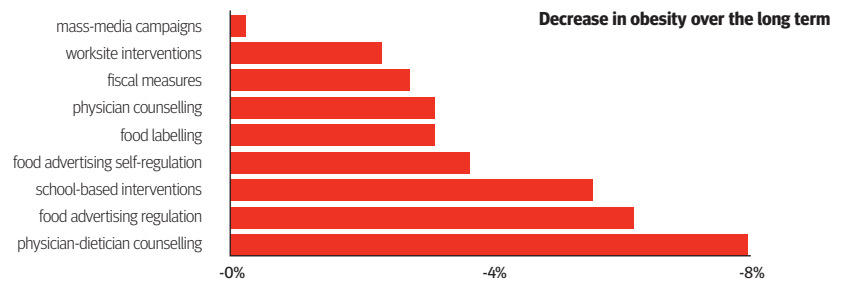
Preventing obesity

The spread of unhealthy diets and sedentary lifestyles have led to rising rates of overweight and obesity. This has meant a greater burden of chronic diseases, such as heart disease and diabetes.

Between 2007 and 2009, the OECD and the World Health Organization undertook an economic analysis of strategies for preventing chronic diseases linked to poor diets, sedentary lifestyles and obesity. As the graph shows, the most efficient interventions are found outside the health sector, in food advertising and in school-based programmes. But healthcare systems can make the largest impact on obesity and related chronic conditions by focusing on individuals at high risk. Interventions targeting younger age groups are efficient in the long term, but they will not have significant health effects for many years.

Most of the preventive measures evaluated as part of the project were shown to be cost-effective, particularly when compared to situations with no systematic preventive measures in place and chronic diseases are treated as soon as they are diagnosed. Since prevention does not always generate reductions in health expenditure, governments should determine what levels of resources they are willing and able to spend on prevention campaigns and use evidence on cost-effectiveness to determine what range of measures would make the best use of the budgets available.

Are prevention programmes effective?



Source: Improving Lifestyles, Tackling Obesity: the Health and Economic Impact of Prevention Strategies, OECD Health Working Paper no. 48. See www.oecd.org/health

Asia after the crisis: Social protection and inclusive growth

Bart W. Édes, Director, Poverty Reduction, Gender, and Social Development Division, Asian Development Bank

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Worried about business

Governments in Asian countries have been responding to the global crisis with stronger social policies. The economy should benefit.

Over the past three decades, developing Asia has made unprecedented gains in reducing the share of the population living in poverty and lifting hundreds of millions out of dire conditions. But the global economic slowdown hit developing Asia hard over the past two years, slashing its growth substantially. Most affected were nations heavily dependent on OECD member countries for their export sales. Although growth has picked up again and is expected to accelerate through 2010, the pace will be much slower than recent rates–which included a 9.5% surge in 2007.

While the global slowdown did not drag Asia as a whole into recession, it either slowed or halted poverty reduction in the region. Among the people hardest hit have been those just above the internationally recognised $1.25-a-day poverty line, including those working in labour-intensive export industries, like electronics, ready-made garments and textiles. Young urban workers and rural migrants employed in the city appear to be among those disproportionately affected. Slowing growth rates have led to job losses, a reduction in working hours and downward pressure on remuneration. Most of the Asians who have lost their jobs enjoy few benefits, such as meaningful severance packages, health insurance and unemployment benefits.

In fact, the slowdown could lead to an additional 80 million people living on less than $1.25-a-day in 2010, analysis by the Asian Development Bank (ADB) shows. In addition, the diminished pace of growth could push an additional 108 million people into poverty. The Chinese Academy of Social Sciences estimates that up to 41 million workers in the People's Republic of China lost their jobs during the economic slowdown, and that the urban

jobless rate hit 9.4%. About 670,000 small and medium-sized enterprises have closed there, adding to the jobless figures.

The social impacts of the slowdown have affected men and women differently. The difficult economy has often forced women to take on additional, informal and even degrading work to make ends meet. In Cambodia, for example, 70,000 workers lost their jobs in the garment industry. Most of them were young women whose rural families depend upon them for remittances. Many of those laid off have sought work in the entertainment industry, putting them at risk of exploitation and abuse. A survey of Indonesian furniture exporters showed discernible gender-based patterns. Since women workers have usually been involved in parts of the production process, such as packaging, that are considered less critical, they often have been the first to be made redundant.

> Social protection systems help to limit the drop in demand

Governments respond

As elsewhere in the world, governments of developing Asia implemented fiscal stimulus packages to reinvigorate their slowing economies. A share of these packages, ranging between 8.8% of the total stimulus package in Indonesia to 42.1% in Georgia, has been directed to social protection, including cash and in-kind payments to the most affected and least able to cope. Many of the social spending packages have been one-off measures or simply topped-up existing programmes, regardless of their efficiency or impact. Recent spending has generally failed to address the more fundamental weaknesses of social protection programmes, such as patchy coverage and poor targeting.

The challenging economic times have stirred thinking among decision-makers about what must be done to ensure adequate financing of social protection programmes in the future, including old-age pensions, health insurance systems and transfers to the very poor and incapacitated. In fact, more people now believe that social protection measures can quickly help those most affected during an economic crisis, while also giving the economy a welcome boost.

Take China, which has recently expanded its basic medical coverage scheme in rural areas with funding provided through a mixture of individual, local and central government resources. For the poorest, though, this does not provide sufficient support, particularly in the event of health catastrophes. It has now been supplemented by a new medical assistance programme. The country intends to spend $124 billion on the first phase of a 10-year overhaul of the healthcare system and has set a goal of providing universal basic health coverage to all by 2020.

Bolstering social protection

In developing Asia, rising overall prosperity over the years has been accompanied by growing inequality, poor social service delivery and lingering real risk of impoverishment in the case of calamity, such as accident, sudden illness, job loss, or natural disaster. The informal social protection mechanisms traditionally used in the region are becoming unsustainable due to changes in family structures, working habits, cultural values and urbanisation. Governments of Asia's developing countries only dedicate about 4.3% of their GDP to social protection.

The talk these days in developing Asia is about rebalancing–reducing reliance on exports to older industrialised economies overseas and instead boosting domestic consumption and intra-regional trade. Social protection systems help to limit the drop in demand when the economy dips and can help to re-orientate the economy. Putting in place a more reliable and extensive social safety net will turn some part of the region's precautionary savings into higher consumption rates.

Moreover, social protection and wise spending on education represent investments in human capital, which is key to a competitive economy with sustainable growth. Social protection helps to forge more cohesive and inclusive societies, too.

So while the global slowdown has dealt a blow to large numbers of Asians, it has, like earlier crises, generated new thinking and policy action. In the next few years, watch for the steady expansion of social protection measures in several countries. While sharp differences will remain in the social policy choices and funding priorities among countries, the new trend is clearly visible and growing.

Visit www.adb.org

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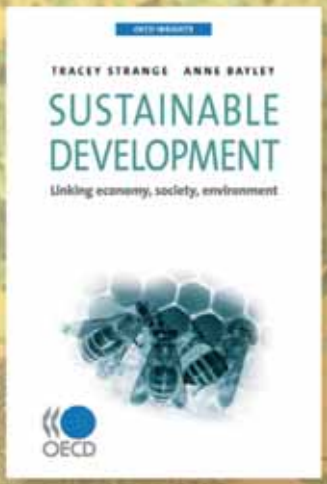

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Tax for development

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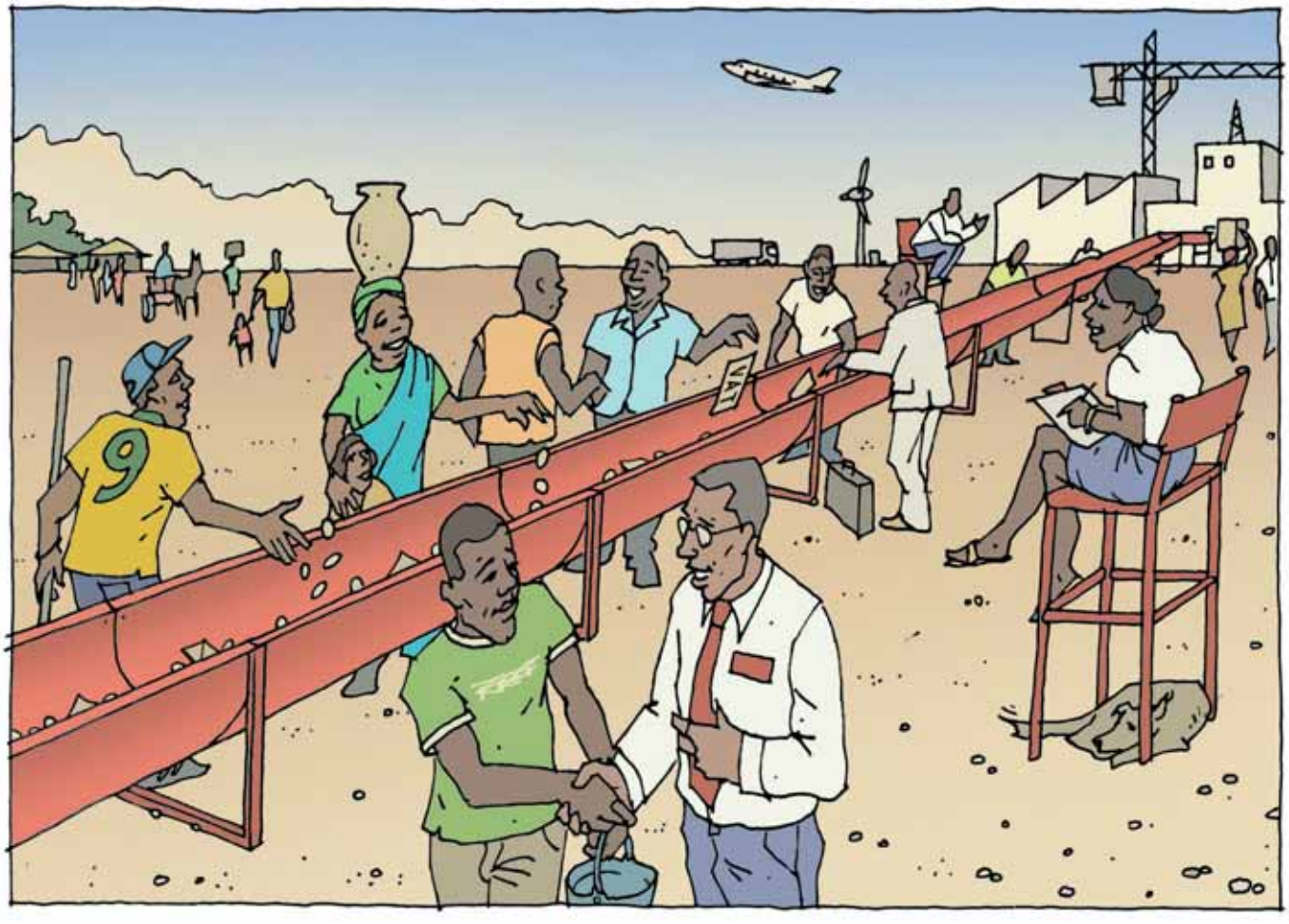

Reforming tax systems can boost development by giving countries more autonomy. This can lead to broader reforms too.

People in developed economies struggling to close burgeoning deficits incurred in the crisis by raising taxes or cutting spending could be forgiven for thinking that developing countries are concerned with the same priorities. But even in good times, dealing with fiscal challenges is an ordeal.

Forget about tax rates or tranches, poor countries often quite simply lack the resources and capacity to build effective tax-collection systems. Despite some recent improvements in revenue-raising efforts, half of sub-Saharan African countries still mobilise less than 15% of their GDP in tax revenues, as against an average of around 35% in OECD countries and 23% in Latin America. This makes it difficult for the state to function properly, let alone to deliver on wider roles, such as social services or a better business environment.

Developing countries know that, for their economies to grow and to attract business and jobs, and ultimately eliminate poverty, they must build capacity, strengthen infrastructure, combat corruption and develop transparent financial systems. They also need to work on a global level if they are to retain their already scarce resources by combatting illicit financial flows and reduce the impact of tax havens.

Tax revenue is central to achieving all these objectives. It is about providing a stable and predictable fiscal environment

to promote growth and, in the longer term, reducing dependence on development aid. Taxation is also about "good governance", because tax systems work as vehicles for enhancing state-society relations and improving public accountability. In other words, how taxes are raised matters as much as how much. What is more, the evidence shows that reforms which begin in tax administration may inspire the reform process in other parts of the public sector, which would be good news for those developing countries wishing to jumpstart their reform efforts.

Making tax systems work is easier said than done. Attitudes have to be changed. Ordinary people may be unwilling to pay tax, frequently reflecting an accurate perception that officials themselves may be corrupt, and that governments consistently misuse public funds. Elites are equally hard to tax and may be able to use havens or evade taxation. It is also difficult to collect tax from low-income, agrarian economies with large informal sectors or to avoid coercion to raise those taxes by local officials.

The external environment also poses new challenges. There has been an international shift away from taxes on trade, and this has added to the problems of domestic revenue-raising (African countries typically rely for more than 40% of their revenue on trade taxes). Striking the right balance between an attractive tax regime for investment and growth, and securing the necessary revenues for public spending is a key policy dilemma.

Globalisation may also exacerbate fiscal problems, as internationally mobile capital becomes more difficult to tax. Large firms and investors have increased their bargaining power over governments, forcing a "race to the bottom" among developing countries competing to provide the most attractive tax incentives. At the same time, governments are under pressure from trading partners and local citizens to ensure their tax systems are transparent and fair.

These challenges have created major new capacity needs in developing countries that the donor community has yet to fully recognise. Up to now, support for revenue and customs sectors has attracted a minimal share of aid, of around 0.1% of official development assistance annually. Donors could increase that amount and see aid as a way to kick-start the move towards sustainable tax systems. Such assistance should be seen as an investment in the future of these countries.

Despite these challenges – and also because of them – now is a good time for tax reform. A shift away from indirect trade taxes in favour of VAT has made tax more visible and consequently provided a base for direct interaction (and formalisation) between state and small businesses. We now know more about how to make tax systems simpler and more transparent, about encouraging more compliance and about effective tax revenue solutions, such as broadening the base for taxation of financial sector profits rather than imposing financial transaction taxes, and so on.

There is now a growing international consensus around these policy themes, backed up by an increasingly powerful and well-organised global community of tax professionals. The call for action is increasingly coming from developing countries themselves. In Africa, the creation of the African Tax Administration Forum, driven, managed and, over time, operationally funded by Africans, provides a key platform for peer learning, capacity development and dialogue on domestic and international tax issues.

The other good news is that there is evidence to show that aid directed at capacity development in the revenue and customs sectors in the developing world is money well spent – an important consideration given the mixed record of technical assistance and donor fatigue in many other areas.

With the economic crisis, the G8 and the G20 have made considerable advances with the assistance of the OECD, IMF and others towards addressing illicit flows, tax evasion, avoidance and tax havens. With more than 300 exchange agreements being signed in 2009, more progress has been made on this front in the last year than in the last decade. Nearly one hundred countries are now committed to transparency and exchange of information standards and are in the process of implementing them. This number will grow quickly as developing countries become directly involved in the debate. The key issue now is how developing countries can best be supported to take advantage of the more transparent international environment to strengthen their tax systems. If they can achieve that, they will strengthen their development potential significantly.

> Development aid directed at the revenue and customs sectors is money well spent

Visit www.oecd.org/tax

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African tax administration: A new era

Oupa Magashula, President, African Tax Administration Forum (ATAF)

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The launch of the ATAF marks a milestone in the continent's quest for greater self-reliance, economic growth and social development.

Anyone who doubts the importance of tax for spurring growth and development should look no further than Africa. There, countries do not need to be convinced that tax administrations play a critical role, not just in raising funds for vital services, such as healthcare or policing, but for state-building and good governance, as well as for promoting economic development. Effective, efficient and capable tax authorities able to mobilise domestic fiscal resources are essential if they are to provide governments with sustainable, domestically-generated revenue, thereby reducing the reliance on foreign investment and development aid. This will give African states the fiscal space to determine spending priorities in line with their own national objectives and socio-economic needs.

To demonstrate this conviction, 25 African tax administrations signed an agreement at a major conference in Kampala, Uganda in November 2009, formally constituting the African Tax Administration Forum as an independent legal body, with its own council, and headquarters in South Africa*.

For the ATAF, taxation is essentially about people, about the citizens of a country and the relationship they have with the state they are living in. Taxation affects all citizens, whether they are taxpayers or not. The way taxes are raised has an impact on the economically active–the employed, corporations, small business, traders and consumers. For them, raising taxes is about economic cost, the quality of service they receive as the providers of revenue and the social benefits they receive as citizens. The way taxes are spent also has an impact on the lives of citizens. Where the expenditure is seen to bring tangible benefits, providing means for the state to govern, pursue policies and provide for the social and economic needs of its people, it also plays a role in fostering legitimacy and responsiveness.

Clearly, tax administrations have the potential to be a force for development, state-building and social cohesion, making a difference to the lives of millions of Africans across the length and breadth of the continent. This is why the establishment of ATAF is a cause for hope for Africa as it wrestles with the social, economic and political challenges of the 21st century.

Strategic reasons for charting a new course

The need to mobilise domestic revenues for development has become even more acute in the wake of the global economic crisis, which has resulted in the near stagnation of development aid and greater difficulty among the smaller, poorer countries in attracting private capital flows.

For African countries, the crisis brought into sharp focus the importance of urgently addressing the structural factors that hamper economic and social development and looking for viable domestic solutions. Taking centre stage is an approach to development that aims to put control over the developmental agenda firmly in the hands of the African states themselves.

Being able to rely on domestic sources of funding in the form of taxes will allow African states to reduce their dependency on official development assistance to fund development. It will give African states the room to determine their own development priorities and fund them accordingly without having to mollify donors, who attach conditions to development aid that often reflect the interests of the donor rather than the recipient.

Several studies have indicated that developing countries have the potential for greater domestic resource mobilisation. The 2005 United Nations Millennium Project estimated that these countries could increase their domestic revenue by about 4% of GDP over the next 10 years.

Challenges include the narrowness of the tax base, which limits the opportunity for collecting additional revenue. In many countries, the largest share of tax revenue is generated from natural-resource taxes, such as income from production-sharing royalties and corporate income tax on oil and mining companies.

The extent of the informal, or shadow, economy in developing countries also hampers efforts at broadening the tax base. Shadow-economy activities range from small-scale informal traders, such as hawkers and unregistered small businessses, to registered businesses that fail to declare profits and criminal syndicates that profit from activities such as drug trafficking and the smuggling of counterfeit goods.

A further challenge for tax administrations is the loss of revenue from assets that are held offshore, typically by wealthy individuals who make use of tax havens. Data on revenues lost to developing countries from evasion, avoidance and the use of tax havens is unreliable, and estimates vary greatly. Most estimates, however, exceed the level of aid received by developing countries–around $100 billion annually.

Significant revenue leakage also occurs as the result of illegitimate shifting of profits to jurisdictions where lower rates apply through transfer-pricing manipulation and by resorting to a host of sophisticated and advanced tax planning and avoidance measures.

> Developing countries could increase their domestic revenue by about 4% of GDP over the next 10 years

A fact sheet compiled by the European Network on Debt and Development puts the illicit capital flight from developing countries at anything between $500 and $800 billion per year, with commercial tax structuring, criminal activity and corrupt money passing hands contributing 64%, 35% and 5% respectively. More simply put, it has been said that for each dollar that goes to the South in terms of aid, more than seven dollars come back to the North through illicit proceeds.

Forum for the future

So what can ATAF achieve? The first aim is to maintain its long-term objective to work for better tax administration in Africa, for only then will African countries be able to meet their sustainable development and poverty-reduction goals and enhance good governance on the continent. To underpin this, ATAF will work to set up an African Tax Centre as a base for multilateral tax work in Africa, gather intelligence, organise high-level conferences and regional seminars and develop best practices through experience-sharing activities.

A capacity-building programme for its members is already underway. ATAF also aims to stimulate continental and international dialogue on the issues affecting African tax administrations and to foster links with academic institutions in Africa with regard to tax education, skills development and research.

Above all, ATAF's mission is to mobilise domestic resources more effectively and improve the accountability of African states to their citizens. Key subjects for future discussion are the removal of incentives granted to investors and issues related to exemptions of aid-funded goods and services that weaken the tax system, create considerable cost and complications, and open the way to corruption. Equal treatment of taxpayers is central to boosting the credibility of revenue administration, simplifying tax systems, broadening the tax base and encouraging voluntary compliance by local and multinational taxpayers.

A solid organisational infrastructure for ATAF will be needed, including a general assembly comprising all member states as the highest decision-making body of the Forum. The dates for the first general assembly will be decided at the first meeting of the ATAF Council in April 2010.

ATAF is an important investment and will be funded through membership fees and donor support for capacity development and projects. In the initial stages, donors are also committed to meeting the funding gap of about $2 million over two years. The official launch of ATAF in Kampala clearly demonstrates that African countries have the commitment and will to take the necessary steps towards capacity-building, enhanced tax administration and good governance.

Taxation is the lifeblood of development, and an African voice is a critically important addition to the global tax arena. ATAF is a concrete expression of what developing countries can do–and are doing–to mobilise their domestic resources and meet development goals.

Visit www.oecd.org/tax and **www.sars.gov.za/home.asp?pid=10421**

* The tax administrations that signed the agreement are those of Botswana, Chad, Egypt, Eritrea, Gabon, Gambia, Ghana, Kenya, Lesotho, Liberia, Malawi, Mauritania, Mauritius, Morocco, Namibia, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, South Afria, Sudan, Uganda, Zambia and Zimbabwe.

Corporate responsibility and paying tax

Thomas Scheiwiller and **Susan Symons**, PricewaterhouseCoopers*

Children in a crèche near Landau colliery in South Africa. Anglo American mining group says two thirds of its tax payments are made in developing countries.

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Some major businesses are starting to view taxation as a mainstream part of their corporate social responsibilities. Others should follow their example.

If we look back 20 years or so, we can see how aspects of corporate responsibility have developed and become embedded in the mainstream. Health and safety is a good example. Today, workers' health and safety is a core and well-regulated aspect of good business management, with clear benefits in employee welfare and reduction of working days lost. But this was not always the case. Twenty years or so ago, health and safety was only just beginning to be considered as a core business responsibility, following some high profile industrial accidents, with campaigning groups arguing that tougher regulation and better business practices were required.

Today we see that paying tax is already being looked at as an element of corporate responsibility, so it is interesting to ask the question: how might this develop in the future? The recession and the financial crisis have deepened the lack of public trust in business and led to much wider public interest in what tax companies pay. Campaigning groups are active, with numerous reports from non-government and non-profit organisations in the past year or two calling for more transparency and regulation over companies' tax affairs. And some corporations are taking leadership positions and treating tax as an element of their approach to corporate responsibility.

There is no universally agreed definition of "corporate responsibility". For the leading companies in the area, we suggest it is simply about how their business adds value, now and in the future, for shareholders, but also for other stakeholders, including employees, customers, government and the wider community. Johnson and Johnson,

the US-based worldwide consumer healthcare group, state this clearly in "Our Credo", a set of operating principles that they have followed for over 60 years. In the Credo, they put their responsibility to shareholders after that to customers, employees and communities, believing that if they follow these principles, the business will survive and shareholders will receive a fair long-term return.

Paying tax into public finances is clearly part of how business contributes to society. Looked at simply, companies affect the community in three dimensions–social, environmental and economic. Paying tax is clearly part of the economic dimension, and how companies contribute to the creation of prosperity and to stability. Taxes provide essential public revenues for governments to meet economic and social objectives. Other aspects of the economic dimension include creating jobs and employment, and generating business for suppliers.

However, we would argue that taxes in this context involve much more than just the corporate income tax on companies' profits; they also include all the other taxes corporations pay, such as employer taxes and property taxes, and those they generate and administer through their economic activity, such as VAT, and employee taxes deducted through the payroll. Our work, using our Total Tax Contribution Framework, has shown that on average in the UK, companies bear nine different taxes, and collect four others; and that corporate income tax is less than half (47%) of their tax cost. In Switzerland, the average figures are 18 taxes borne and 10 taxes collected; corporate income tax is 30.2% of taxes borne (see references).

What campaigners want

Some of the groups campaigning on tax would like to see a change in reporting standards to require multinational companies to report their tax affairs in much more detail in their audited accounts, essentially a profit and loss account, assets and tax charge for every country where they operate, known as country-by-country reporting. The campaigners want this because they believe it would give greater transparency to tax avoidance and alleged profit shifting by multinationals, particularly out of developing countries.

These proposals would clearly involve a great deal of cost and effort for many companies, which business may be concerned about. Also it is not clear what the benefit would be for users of financial statements through such detailed reporting, or whether the proposals would achieve their aim of increasing tax revenues in developing countries. Nevertheless, such proposals clearly reflect a lack of public trust in corporate behaviour and show that tax is a complex area, and difficult for the non-tax expert to understand.

Greater transparency has been a theme of many previous corporate responsibility campaigns. The extractive industries have been at the forefront of the country-by-country reporting campaign. Mining companies often operate in resource-rich developing countries, and there is naturally much interest in their tax and other payments to government, as part of their licence to operate and the price for natural resources.

It is therefore interesting to see how some mining companies have already taken on the challenge of greater transparency on tax. In their Report to Society, Anglo American, the UK-based global mining company, discuss their payments with government (including tax) alongside other aspects of their corporate responsibility. Anglo American report their total tax contribution by country as part of their economic value added, or the economic dimension, including all the different taxes that they pay and collect, such as corporate income tax, royalties, employer's social contributions, and employee taxes deducted through the payroll. They explain how all these taxes are generated across the life-cycle of a mining project, and show that two thirds of their tax payments are made in developing countries.

This type of reporting is quite different from the country-by-country proposal, which focuses solely on corporate income tax and the tax charge in the financial statements. Arguably, it better reflects how taxes are part of the economic benefits that companies bring to society.

We believe that paying tax has already started to develop as a corporate responsibility issue. We suggest that large companies, if they have not already done so, should start to think about where tax fits into their approach and strategy on corporate responsibility. Not all companies will want to be a leader in this area, but not to have a position could well be a risk.

We also suggest that more companies need to take up the challenge of greater tax transparency and how better to communicate their tax affairs. While there could be risk in providing more information, there may also be value in corporate reputation.

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Visit www.pwc.com

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Transfer pricing: A challenge for developing countries

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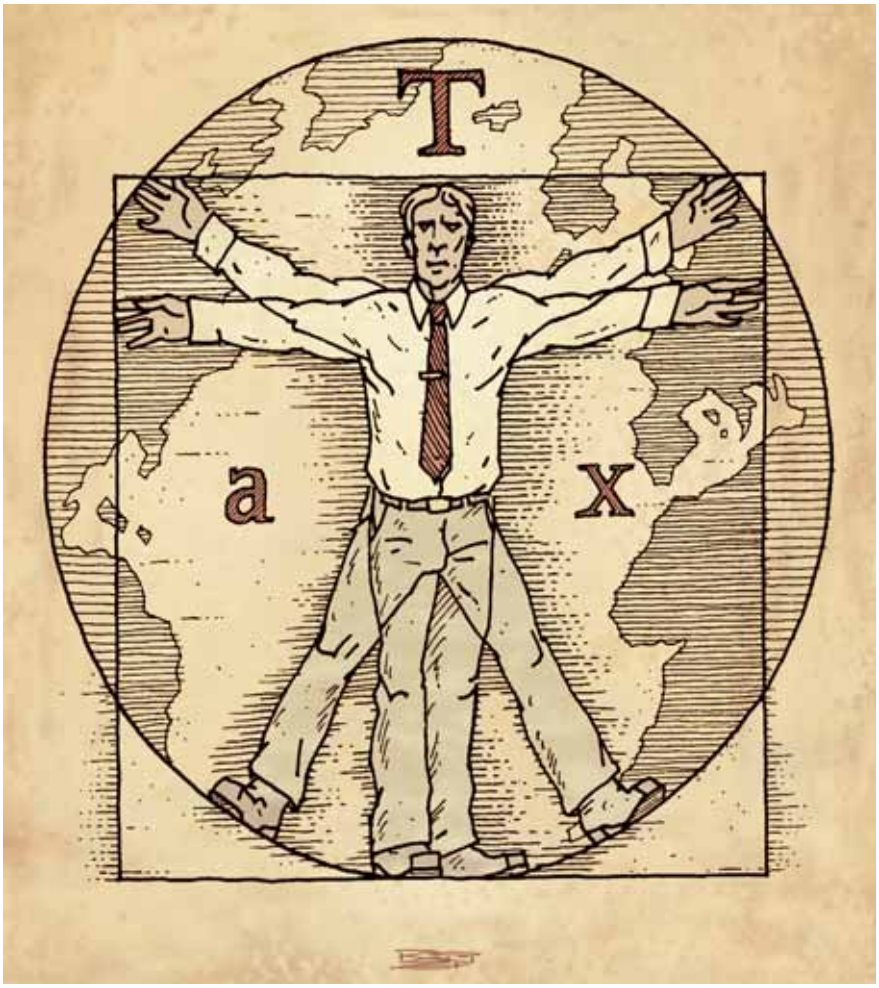

A lot of debate about tax and developing countries nowadays tends to focus on how to reduce revenue leakage through offshore tax havens. But there is another hot issue called transfer pricing which developing countries have to be mindful of, particularly if they want to avoid the risk of losing out on tax revenue from cross-border transactions carried out by multinational enterprises. How does it work?

A large proportion of world trade is accounted for by cross-border trade taking place within multinational enterprises, where branches or subsidiaries of the same multinational enterprise exchange goods or services. These transactions within the group are not exposed to the same market forces as transactions between independent enterprises. They are referred to as "controlled transactions". If the prices of these transactions are artificially lowered or increased they may lead to taxable profits being shifted from one country to another. Take a beverage company located, say, in Mexico, which has a subsidiary in France. Let's assume that the French subsidiary pays royalties to the Mexican headquarters for the rights to sell its drinks. Taxes are owed in France based on the French subsidiary's results. The higher the royalties paid by the French subsidiary, the lower the taxable profits in France. The French tax authorities will be satisfied if they see that the royalties paid by the French company to its headquarters in Mexico are not higher than those that would be paid to an independent enterprise for a similar transaction. But if the royalties are too high, there is a possibility that profits are being shifted out of France to reduce tax liabilities there. The "arm's length principle" is used to address such issues.

Under the arm's length principle, one compares the remuneration from cross-border controlled transactions within multinationals with the remuneration from transactions made between independent enterprises in similar circumstances. The "arm's length principle" has become the international norm for allocating the tax bases of multinational enterprises among the countries where they operate. All OECD countries use this principle, as do an increasing number of non-OECD countries, such as Argentina, China, India, Russia, Singapore and South Africa.

Different methods

The question is how to determine an arm's length price for cross-border transactions within MNEs. The OECD lists as many as five methods for approximating arm's length outcomes and these are explained in detail in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Transfer Pricing Guidelines").

First, the Comparable Uncontrolled Price (CUP) method compares the price charged for property or services transferred in a controlled transaction within a multinational enterprise to the price charged for property or services in a comparable transaction on the open marketplace, or so-called "uncontrolled" transaction. In theory, this is the most direct way to apply the arm's length principle and where it can be reliably applied, it is

regarded as preferable to all other methods. The trouble is that in many industries, few uncontrolled transactions in the marketplace satisfy the comparability requirements needed for this method to work reliably. In effect, a seemingly minor difference in the property transferred in the controlled and uncontrolled transactions could materially affect the price and the reliability of the comparison between the two. For this reason, the CUP method is mostly used for trading commodities.

The resale price method is most useful for buy-and-sell operations. It starts from the price at which products purchased from an associated enterprise are resold in the market place. A resale price margin is applied to cover sale and other operating expenses, work out an appropriate profit given the functions performed by the reseller, its assets and its risks, and find an arm's length price for the original property transfer between the associated enterprises. The cost plus method starts from the costs incurred by the supplier of property or services in a controlled transaction. An appropriate mark-up is then added to these costs, for the supplier to make an appropriate profit corresponding to its functions, assets and risks. The method is mostly used for contract work in manufacturing and back-office services.

The same reasoning can also be applied to net profit margins. The net margin taxpayers make from controlled transactions can be compared to the net margin earned by the same or other taxpayers in similar uncontrolled transactions in the marketplace. This is the so-called transactional net margin method or TNMM.

Finally, the division of profits in the controlled transaction can be compared to the one that independent enterprises would have expected to realise from similar transactions, in what is known as the profit-split method. This profit method is mostly used in cases where both parties to the transaction contribute valuable intangibles.

Historically, OECD countries have tended to treat the profit methods–that is, both TNMM and the profit split method–as last resort for when the other traditional transaction methods do not work. In practice however, profit methods are now widely used in many countries. The transactional net margin method is actually proving easier to use than traditional transaction methods, being less sensitive to minor product differences for instance. The profit split method is also spreading, partly because of the growing importance of intangibles in today's business transactions, in the e-world or in financial products, for instance, for which comparables can be scarce.

As a result, the OECD is now considering removing the "last resort" status of profit methods, and putting the emphasis on the selection of the most appropriate method for a particular case, and taking account of the respective strengths and weaknesses of the various methods. Public comments have been gathered and new guidance is being prepared (see www.oecd.org/ctp/tp/cpm).

In practice, one key difficulty in applying transfer pricing methods is to find open market transactions between independent enterprises that are comparable to the controlled transactions within a multinational enterprise. This is an issue for developed as well as developing countries, although it is magnified for developing ones due to the smaller size of their economies and smaller number of independent enterprises operating in their markets that can be looked to for comparisons.

> The goal for developing countries is the same as for OECD countries: to protect their tax base while not hampering foreign direct investment and cross-border trade. The arm's length principle can help

Business restructuring

One major OECD on-going project that developing countries need to follow is to reach consensus on how the arm's length principle applies to business restructurings involving the cross-border redeployment of operations by a multinational enterprise. Such restructurings can have dramatic effects on the allocation of the profit (or loss) potential among the members of the multinational enterprise and affect the corporate income tax paid in each of the countries where the group operates. The arm's length principle and the OECD Transfer Pricing Guidelines can help to lay out the appropriate questions and point to solutions.

For instance, what operations does the restructuring involve? Have valuable intangible assets, such as patents and trademarks, been moved? Who should bear the termination costs that may follow from such restructuring: the restructured entity itself, the parent company that made the decision to restructure, or the entity to which the operation is being relocated? How does the arm's length principle apply in such cases? The OECD has been working with the business community and stakeholders since 2005 on this issue. A draft report was released for public comment in 2008 (see www.oecd.org/ctp/tp/br) and is expected to be finalised in 2010.

No method is perfect, and the inherent risks for disputes are not hard to spot. It is little wonder that a survey by Ernst and Young in 2007-08 found that 74% of parent and 81% of subsidiary respondents in MNEs believed that transfer pricing will be "very important" or "absolutely critical" for their organisations over the next two years.

Take our example of the Mexican beverage company and its French affiliate. In case of a dispute with the French authorities on the arm's length price for the royalties, the risk for the firm is that the same amount of profits will be taxed twice–once in Mexico and once in France. The Mexican enterprise will want to avoid such double taxation. But Mexico and France will each rightly want their legitimate share of the firm's profits. It is therefore critical to reach a consensus on the arm's length price that the Mexican and French authorities, as well as the taxpayer, can use to arrive at an agreement.

Generally, under the OECD Model Tax Convention, double taxation can be resolved between the states concerned by following the Mutual Agreement Procedure (or MAP for short) which caters for an increasing number of complex international tax disputes, including tricky transfer pricing disputes (see Manual on Effective Mutual Agreement Procedures at www.oecd.org/ctp/memap). The OECD Model Tax Convention now includes compulsory, binding arbitration procedures for cases left unresolved after two years of Mutual Agreement Procedure.

Developing economies are keenly aware of the challenges posed by transfer pricing. Their goal is the same as for OECD countries: protecting their tax base while not hampering foreign direct investment and cross-border trade. The arm's length principle can help them achieve that goal. The key is to tailor the legislative measures and administrative effort to the strategic needs and resources of each country. Applying the arm's length principle can become complex and resource-intensive, though policymakers should bear in mind that most OECD countries started modestly and built their transfer pricing legislation and practices gradually over several years. Indeed, they are still in the process of improving them. Tax authorities in developing countries who wish to implement transfer pricing legislation may focus on the most common types of transactions and sectors in their economy first, for instance the exploitation of natural resources, manufacturing, or service activities. Enforcement objectives should be realistic, given the available capacity, and compliance requirements made reasonable for taxpayers in light of the size of the cross-border trade. So-called "safe harbours" are sometimes used to simplify compliance by small taxpayers, or to deal with small and less complex transactions carried out by multinational enterprises.

Given the global and sometimes controversial nature of transfer pricing, it is important to develop internationally shared principles to help each country fight abusive transfers of profit abroad, while at the same time limiting the risk of double taxation of those profits. This is what the arm's length principle is for. As more developing countries apply it, new lessons will be learned. This is a key step on the road to building a stronger, cleaner and fairer world economy.

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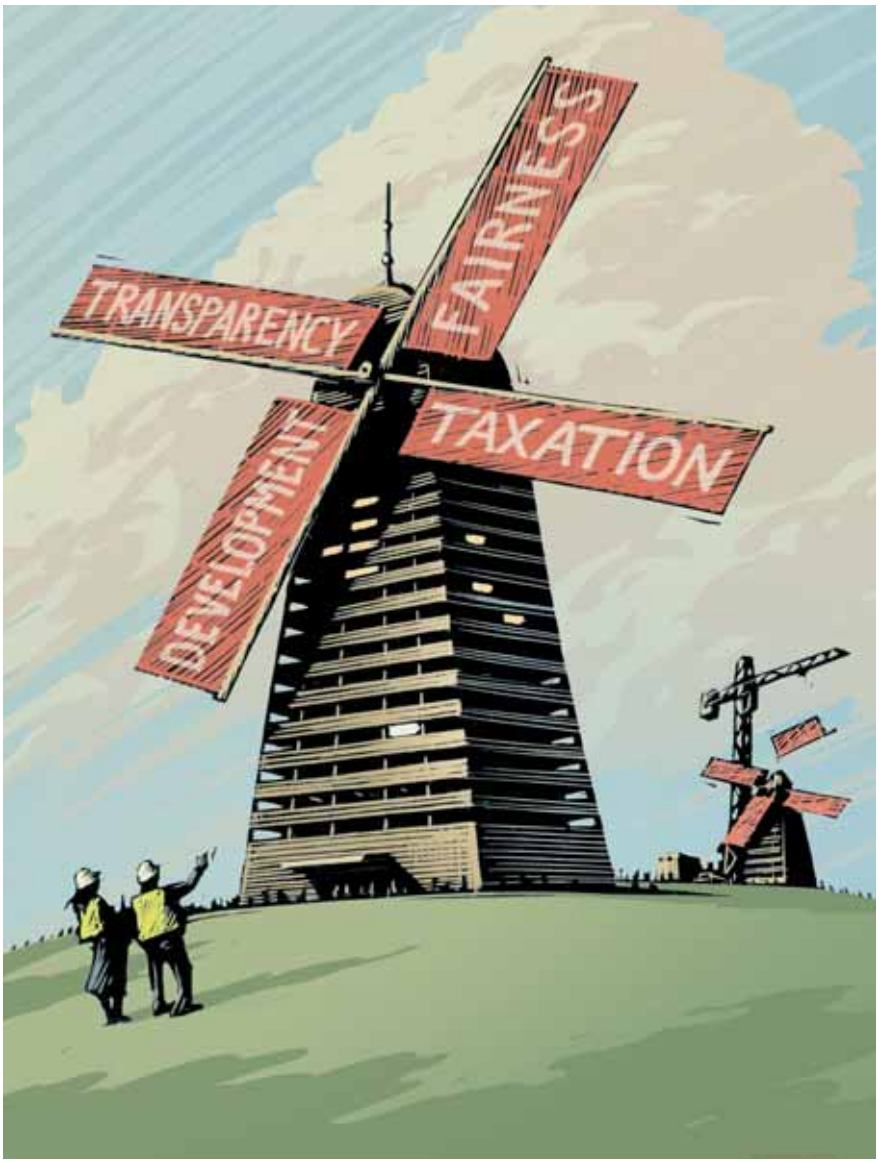
A new social contract?

David McNair, Senior Economic Justice Adviser, Christian Aid



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Taxation is receiving more attention in debates on development.

Emblazoned on the front of the Internal Revenue Service building in Washington DC is a quote from American poet, author and judge, Oliver Wendell Holmes: "Taxes are what we pay for a civilized society." It is the potential to inspire better governance through raising revenue that matters to civil society, and everyone has a role to play. To act as responsible corporate citizens, companies must pay the right amount of tax and be transparent about it. Yet Christian Aid estimates that developing countries lose as much as $160 billion–greater than the global aid budget–to companies dodging tax.

Civil society groups such as the Tax Justice Network have long been campaigning for an international accounting standard for country-by-country reporting to provide a global picture of the financial activities of companies, where they are making profits and where they pay tax.

This standard, which has reached the desk of the OECD and has the support of the UK government, would assist revenue authorities and civil society in holding companies to account–particularly in relation to complex transfer-pricing arrangements.

The inclusion of such a standard in the OECD guidelines for multinational companies would firmly cement transparency of tax payment as a pillar of corporate responsibility.

Civil society has a role to play in holding governments to account for how they raise and spend revenue. To invest in the social contract, we need to see the benefits and know that everyone is paying their fair share. A growing movement of local organisations in developing countries understands their tax systems and is monitoring budgets and expenditure.

> Developing countries lose as much as $160 billion–more than global aid–to companies dodging tax

In West Africa for example, civil society groups recently met to discuss the nature of their tax systems under the banner of "No Representation without Taxation", in recognition of the importance of tax in the democratic process. The prevailing theme at this conference was the need for transparency at national and international levels.

Governments, for their part, must be much more transparent about how they raise revenue and where they spend it, so that their decisions are open to scrutiny. This is particularly important when it comes to decisions about the generous tax

incentives given to companies in an effort to attract investment. In reality, many of these incentives do little for the country's economy and are open to abuse.

Transparency is particularly important for companies extracting oil, gold and other minerals. This is a priority area for the international network, Publish What You Pay. For example, poorly negotiated and secretive mining stability contracts left African governments unable to benefit from the commodity price boom in 2008 and restricted the ability of governments to change domestic tax legislation.

> A growing movement of local organisations understands and monitors their tax systems

Multilateral organisations and donors have a role to play in helping developing countries raise revenues. Sharing of expertise between revenue authorities is essential, while the use of aid to build more efficient, transparent and stable tax regimes would be a long-term strategic investment.

Governments also need access to information on individuals and companies holding assets in secretive tax havens so they can target those unfairly dodging tax. Significant progress has been made, but civil society organisations are demanding a swift expansion of agreements to include developing countries in a truly multilateral agreement.

A commitment to move towards automatic exchange of relevant information would ensure that information is delivered effectively, when it is needed, rather than requiring tax authorities to jump through extensive bureaucratic loopholes.

Raising revenue in the developing world is not going to be easy, but, in the long term, it would enable countries to chart their own course for development. For it is only when governments are dependent on the economic activity of their own citizens, individual and corporate, that they will truly act in their interests. This is the social contract. This is the challenge for everyone to play their part.

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Pricing a hypothetical

In 1995 the OECD published the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the Guidelines), which provide guidance on the application of the arm's length principle (ALP) to dealings between associated enterprises. However, the Guidelines do not address the application of the ALP to dealings between a Permanent Establishment (PE) and the remainder of the entity of which it is a part (intra-entity dealings)–a topic which has been, and continues to be, hotly debated in international tax circles.

The attribution of Profits to Permanent Establishments under the OECD Model
As a result of a project that began in the 1990's, on June 2008 the OECD published the Report on the Attribution of Profits to Permanent Establishments (the Report). This Report proposes a new approach to the attribution of profits to PEs–the "authorised OECD approach" (AOA).

The basic premise of the AOA is that the profits to be attributed to a PE are those that the PE would have earned at arm's length if it were a legally distinct and separate enterprise performing the same or similar functions under the same or similar conditions and dealing wholly independently. The AOA comprises a two-step analysis:

Step 1 requires the identification of the activities carried on through the PE, by way of a functional and factual analysis–guidance for which is found in the comparability analysis section of the Guidelines. This analysis is to be undertaken hypothesizing the PE as a separate and independent enterprise capable of undertaking functions, owning and/or using assets, assuming risks, entering into transactions with other related and unrelated enterprises, and, more controversially, entering into dealings with the enterprise of which it is a part. This recognition of intra-entity dealings has been the cause of much debate, particularly as it is at odds with paragraph 3 of Article 7 of the current OECD Model Tax Convention (OECD Model), which is generally interpreted as prohibiting the recognition of intra-entity dealings in determining a PE's profit.

Step 2 requires that where intra-group dealings are capable of being recognized, the pricing of such dealings should be determined by applying the ALP. This is to be done through application, by analogy, of the Guidelines.

The AOA, by way of its references to the Guidelines, relies on transfer pricing principles for determining the attribution of profits to a PE. However, due to the changes required to Article 7 to fully implement the AOA, a two-stage process has been adopted:

Stage one saw the Commentary on Article 7 of the OECD Model amended in the 2008 update. However, this update was limited to the conclusions of the Report that were considered consistent with the existing Article 7 and its limited scope for the recognition of intra-entity dealings.

The second stage, which is currently underway, has thus far involved the drafting of a new Article 7 which will allow for the full adoption of the AOA. The most recent draft for a new Article 7 was released for public comment on 24 November 2009, and it is anticipated that it will be included in the 2010 update of the OECD Model.

The AOA and the United Nations Model Tax Convention (UN Model)
Interestingly, the UN Committee of Experts on International Cooperation in Tax Matters, at its meeting in October 2009, agreed that it would not adopt the AOA in its planned update to the UN Model. This decision was based on the Committee's view that the AOA is in direct conflict with paragraph 3 of Article 7 of the UN Model, and that this paragraph continues to be appropriate in the context of the UN Model.

The AOA and transfer pricing- what does the future hold?
These recent developments suggest that transfer pricing–arguably one of the most important tax issues facing multinational enterprises and tax administrations today–will continue to increase in importance beyond its traditional focus on associated enterprise dealings through its application, by analogy, under the AOA to intra-entity dealings. However, how the AOA will be adopted in practice, especially given the two-stage implementation and the position recently adopted by the UN Committee, is still to be seen.

Harry Tonino and Joel Cooper
IBFD International Tax Academy

Recession provides tough stress test for global transfer pricing rules

Multinationals planning for economic recovery need to redraw their transfer pricing policies in the new environment.

Many transfer pricing systems have come under unprecedented stress as companies and revenue authorities around the world deal with the impact of the severe economic downturn and the subsequent modest recovery, a recent report from KPMG's Global Transfer Pricing Services group concludes.
Tax authorities–under pressure to provide revenue to their governments–are demanding additional documentation from formerly profitable companies that achieved losses and, therefore, paid less tax, KPMG partners and professionals indicate in the report, "Planning for the Recovery – Examining Transfer Pricing in the Current Environment and Beyond."
"The economic events of 2008 and 2009 have dramatically tested the entire transfer pricing system—a system that was developed over a period of increasing globalization and prosperity," said Steven Fortier, global leader of KPMG's Global Transfer Pricing Services practice and principal of KPMG LLP, the U.S.-based audit, tax and advisory firm.
"Multinational companies must deal with the difficult business conditions, new guidance and heightened enforcement from tax authorities, as well as their own current practices, to re-evaluate transfer pricing policies in the new and different economic environment," he added.

> **The global downturn has confronted transfer pricing practitioners with a host of challenges**
>
> Steve Fortier, KPMG (Chicago)

Further, Fortier said that to meet increasingly stringent tax authority requirements, corporate taxpayers will need to find new ways to demonstrate that prices charged for inter-group transactions are appropriate.
The report, which addresses some of the critical transfer pricing issues that companies and their tax departments will continue to face in the coming years, is based on research and insights from leading KPMG transfer pricing professionals around the world.

About KPMG International

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 146 countries and have 140,000 people working in member firms. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

Benchmarks difficult to find

According to the KPMG report, a key challenge during the transfer pricing audit process has been the lack of comparable transactions to act as benchmarks for intra-group commerce, as economic activity around the world slowed.

"The problem has been felt acutely in the area of third-party benchmarks," said Fortier. "For example, there is a lag in the availability of publicly available financial data, meaning that the full impact of the recession on company profitability is difficult to assess contemporaneously," he explained. "Furthermore, certain companies that may have been used historically as benchmarks may have been acquired or gone bankrupt during the recession, which would reduce the pool of benchmarks and potentially lead to 'survivor bias' in the financial results."

APAs under pressure

Advanced pricing agreements (APAs), often considered clear solutions to transfer pricing issues, have also come under strain, the report concluded. APAs are binding contractual agreements, the terms of which are fixed while the agreement is in force. This means that companies wanting to change agreements because of market changes, falling prices, or revenue losses, may find it difficult to adjust or terminate APAs that no longer match business realities.

"Taxpayers should expect an aggressive approach to their transfer pricing if they do not comply with an executed APA," Fortier said. "That said, understanding the relevant tax authority's views on APAs is important for companies in, or expecting to enter, an APA in the current environment." ■

KPMG report released on transfer pricing

The report cited in this release is "Planning for the Recovery - Examining Transfer Pricing Issues in the Current Environment and Beyond".

Articles in the report deal with such issues as: the implications of the economic downtown and recovery for common inter-company structures, the defense of transfer pricing arrangements in the recession, and the ability of taxpayers to mitigate issues with existing advance pricing arrangements.

The full document is available at: www.kpmg.com/recoveryplanning

Chile's accession to the OECD

©Alex Ibanez/OECD

Michelle Bachelet, president of Chile, greets Angel Gurría, secretary-general of the OECD

Chile is set to become the OECD's 31st member country. It is a momentous occasion, as captured in the following extracts from speeches by President Michelle Bachelet of Chile and by OECD Secretary-General Angel Gurría, following the signing of the agreement on the terms of accession by the Republic of Chile to the OECD Convention, delivered in Santiago, Chile, 11 January 2010.

President Bachelet: The "legitimate and genuine happiness" of which I speak is also matched by a sense of satisfaction and pride because this [Accession] Agreement, although simply the first step on a path of collaboration between Chile and OECD member countries, is also a ringing endorsement of all the progress we have made as a country during these years of freedom and democracy for all Chilean people. What has happened over the last 20 years is historic. Chile has shaken off under-development and is well on the way to achieving developed nation status in a few years' time. But joining the OECD is much more than recognition.

In particular, as Angel Gurría noted, it is the first step on a new journey into the future which will open up major new opportunities to move more quickly towards that long-desired development. Membership of the OECD will help Chile make a qualitative leap forward in terms of public policies and state modernisation. As an OECD member, Chile will work with the world's most advanced economies in seeking solutions to our key economic, social, environmental and other challenges–challenges that are quintessentially global.[...]

My friends, accession to the OECD does not mean that Chile ceases to be what it is: a Latin American country, a democratic country, and a progressive country. Chile will bring to the OECD a vision of a southern country; a middle-income country, with particular experience of economic and social progress, in a framework of democracy and respect for human rights and fundamental freedoms. Nonetheless, I believe that by joining the organisation we will be sending a signal to the world that Latin America has countries such as Mexico, Chile and several others that are moving steadfastly towards societies that are not only more democratic but also more developed and more inclusive. This progress by emerging Latin American countries will be one of the positive developments of the first few decades of the 21st century.[...]

I would like to conclude my remarks by calling on all children of this land, our fatherland, to learn to value what we have built. Because Chile today is not what it was 20 years ago, when joining this forum would have been unthinkable. And because we have achieved this together, in freedom and democracy.[...]

Secretary-General Gurría: Chile's accession to the OECD occurs at a time when international co-operation is becoming ever more important.[...]

The "Chilean way" and its expertise will enrich the OECD on key policy issues. Chile has been embarked on a continuous effort to reform its economy. Over nearly two decades it has developed a strong set of democratic institutions, and it has succeeded in combining robust economic growth with improved social welfare. This experience will be an asset for the OECD as we try to address common issues such as inequality or the coverage and viability of pension systems.[...]

The OECD accession process is in itself a catalyst for reform. Over the past two years, Chile has made a comprehensive and in-depth analysis of its economic, social and environmental policies, practices and institutions, and has taken significant steps in a number of areas.[...]

Now is the time to write a new chapter on global economic governance and international co-operation. It is time to build a stronger, cleaner and fairer world economy. It is time to identify and promote new sources of growth, pursue new ideas for innovation, develop a new agenda for jobs, take steps to reduce inequalities and promote new green-growth strategies. The OECD is honoured to embark on this new endeavour with Chile as a new partner and member country. [...]

Gabriel Garcia Marquez once said, "It is not true that people stop pursuing dreams because they grow old, they grow old because they stop pursuing dreams". Chile is a young country and the OECD is a young organisation: let's pursue our dreams together![...]

The full speeches are available at www.oecd.org/speeches. See also www.oecd.org/chile

Highlights

"It's not just greasing the wheels of business. It is cheating the people," said US Commerce Secretary Gary Locke at a Transparency International-US event held at OECD headquarters in Paris last December to mark International Anti-Corruption Day and the **10th anniversary** of the entry into force of the **OECD Anti-Bribery Convention**. **See www.oecd.org/corruption.**

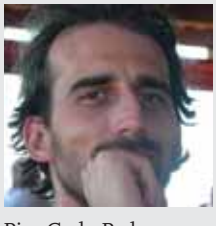
Corruption was on the agenda at the **MENA-OECD** ministerial conference in Marrakech, Morocco, in November, where ministers from the Middle East-North African region and the OECD pledged continued co-operation. The Marrakech Declaration on Governance and Investment was adopted. **See www.oecd.org/daf/investment/declaration** and **www.oecd.org/mena**

The *African Economic Outlook 2009*, one of the OECD Development Centre's flagship reports, received the Interactive Media Award for its website. The website, designed by Liquidlight, rated a perfect score of 100 in five categories, including design and content. Judges included representatives from The New York Times, Microsoft, Time Inc., American Express Company, and Hill & Knowlton.
See **www.africaneconomicoutlook.org** and **www.interactivemediaawards.com**

New ambassador

On 1 February 2010, Ivan Sramko succeeds Jana Kotová as ambassador for the Slovak Republic.

David Sterboul



David Sterboul, a photographer at the OECD, passed away in November at a tragically young age (see his portrait of Pier Carlo Padoan on page 5). We would like to extend our sympathies to his family and friends.

Recent speeches by Angel Gurría

For a complete list of speeches and statements, including those in French and other languages, go to **www.oecd.org/speeches**

Accession of Chile to the OECD

11 JANUARY 2010
Remarks delivered at the Signing Ceremony of Chile's Accession Agreement, Santiago de Chile, Chile.

Towards a stronger, fairer and cleaner world economy

11 JANUARY 2010
Remarks delivered at the Economic Commission for Latin America and the Caribbean, Santiago de Chile, Chile.

Supporting fiscal policy in Mexico for a strong and sustainable recovery

7 JANUARY 2010
Remarks delivered for the release of the OECD Review of Budgeting in Mexico, Mexico City.

Tackling climate change and growing the economy

16 DECEMBER 2009
Remarks to the press at the Climate Change Conference in Copenhagen, Denmark.

Empowering E-Consumers

9 DECEMBER 2009
Remarks delivered at the Conference for Empowering E-Consumers, Washington DC, US.

Foreign Bribery: Who Pays the Price?

9 DECEMBER 2009
Remarks broadcast at the Roundtable on Foreign Bribery: Who Pays the Price? In Paris, France.

International investment for a stronger, cleaner, fairer global economy

7 DECEMBER 2009
Welcome address at the 8th OECD Global Forum on International Investment, Paris, France.

India and the OECD

3 DECEMBER 2009
Remarks delivered at the OECD-India Symposium, New Delhi, India.

MENA-OECD Ministerial conference

21 NOVEMBER 2009
Remarks delivered at the opening of the MENA-OECD Ministerial conference, Marrakech, Morocco.

Twenty years after

20 NOVEMBER 2009
Remarks delivered at a seminar to commemorate the 20th anniversary of the fall of the Berlin Wall, Paris, France.

Innovation: the path to stronger, smarter and greener growth

19 NOVEMBER 2009
Remarks delivered at a meeting with the Keidanren (Japan Business Association), Tokyo, Japan.

Economic Outlook n°86

19 NOVEMBER 2009
Remarks delivered at the launch of the Economic Outlook n°86, Tokyo, Japan.

The Korean G20 Leadership: Assessing the key issues for 2010 – New sources of sustainable and balanced growth

17 NOVEMBER 2009
Remarks delivered in Seoul, South Korea.

Open markets and enhanced global co-operation are key to a stronger, cleaner and fairer world economy

10 NOVEMBER 2009
Lecture delivered at the C. D. Howe Institute, Toronto, Canada.

Restoring growth in a post-bailout era: the crucial contribution of cities

9 NOVEMBER 2009
Remarks delivered at the International Forum of the Americas Forum for Global Cities, Toronto, Canada.

Calendar of forthcoming events

Please note that many of the OECD meetings mentioned are not open to the public or the media and are listed as a guide only. All meetings are in Paris unless otherwise stated. For a more comprehensive list, see the OECD website at **www.oecd.org/media/upcoming**, which is updated weekly.

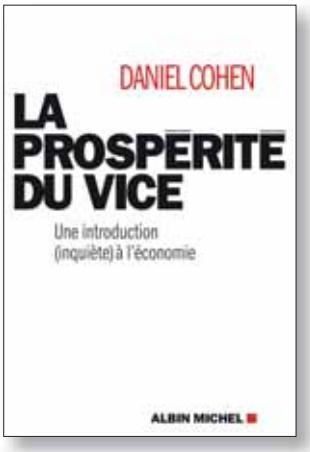
JANUARY	
11	**Chile officially invited to join the OECD.**
19-20	**Evolving Agricultural Policies in a Changing World,** OECD conference organised with the US Department of Agriculture. Washington, DC, US.
20	Publication of the **Economic Assessment of Israel.**
21	Publication of the Economic **Assessment of Chile**.
25	**Economic Forum on Latin America and the Caribbean**, meeting organised by the OECD Development Centre, the IADB and the French government. Participation of the OECD Secretary-General. Bercy, Paris.
27	**Strengthening Developing Countries through Taxation**, roundtable on Tax and Development organised by the OECD.
27-31	**World Economic Forum**, participation of OECD Secretary-General. Davos, Switzerland.
28	**Domestic Resource Mobilisation for Development: The Taxation Challenge**, forum organised by the OECD Centre for Tax and Policy Administration, the Development Centre and the Development Co-operation Directorate.
29	**Regulation: Political Economy, Measurement and Effects on Performance,** conference organised by the OECD Economics Department and the University of Munich. Munich, Germany.

FEBRUARY	
2	**OECD Economic Assessment of China.**
15	**Environmental Performance Review of Greece**, presented by the OECD Secretary-General. Athens, Greece.
16	**Partnerships and Local Governance**, meeting organised by OECD LEED programme.
17	Economics and Security Committee of the **NATO Parliamentary Assembly**, annual meeting with the OECD.
18	**Sustaining a Global Recovery**, high-level parliamentary seminar, organised by the OECD Public Affairs division.
24	**Roundtable on Sustainable Development** discusses how to balance the role of livestock agriculture in meeting global food demand with the need to reduce the sector's impact on climate change.
25-26	**Ministerial meeting on agriculture**, organised by the Directorate for Trade and Agriculture.
MARCH	
8	**International Women's Day**.
23-26	**Agri-environmental Indicators: Lessons Learned and Future Directions**, workshop organised by the Direction for Trade and Agriculture, and the Environment Directorate. Leysin, Switzerland.
24-26	**OECD Seed Schemes** annual meeting, organised by the Directorate for Trade and Agriculture. Christchurch, New Zealand.

APRIL	
12-13	**New Issues in Carbon Markets**, organised by the Environment Directorate. Berlin, Germany.
15-16	**Advancing the Aquaculture Agenda: Policies to Ensure a Sustainable Aquaculture Sector**, workshop organised by the Trade and Agriculture Directorate.
20-21	**G20 labour and employment ministers meet**. Washington, DC, US.
21	**Sustainable Development Sector Strategies and Sustainable Tourism**, workshop organised by the OECD.
24-25	**The International Monetary Fund and the World Bank Group meet**. Washington, DC, US.
MAY	
10-11	**Global Forum on Environment**, organised by the Environment Directorate.
26-27	**Annual OECD Forum.**
26-28	**Ministerial meeting of the International Transport Forum**: Transport and Innovation: Unleashing the Potential. Leipzig, Germany.
27-28	**OECD Council meets at ministerial level.**
27-28	**African Economic Outlook 2010** published during the annual meetings of the African Development Bank. Abidjan, Ivory Coast.

Peace or prosperity

Helmut Reisen, Head of Research, OECD Global Development Division



Malthus is dead, but prosperity for all guarantees neither peace nor happiness. This is the key message emanating from Daniel Cohen's acclaimed new book, *La prospérité du vice: Une introduction (inquiète) à l'économie*. This professor of the École Normale Superieure and deputy director of the Paris School of Economics looks back over four centuries and draws on the thinking of the great economists, historians and sociologists in order to bring us to this insight: prosperity alone guarantees neither peace nor happiness. Despite Cohen's prevailingly pessimistic tone, his pedagogical talent makes this book an exciting and educational read.

The core argument is simple: Malthus is dead, mankind has escaped the population trap and the famine that, through the twin pincers of sinking agricultural yields and rising birth rates, have always whittled mass prosperity away. Globalisation and entertainment are westernising all humanity, as China and India add a sizeable portion of mankind into the market-oriented economy. However, according to Cohen, this development means neither a worldwide shift to market democracy–Francis Fukuyama's "end of history"–nor the unleashing of Samuel Huntington's "clash of civilizations". A much greater risk is that surging countries will go down the path that Europe took during the last 500 years, with the same sorry sequences of war and collapse.

Cohen is by no means an enemy of globalisation, as his previous books show. The chief route out of mass poverty in the world leads through international merchandise trade (financial globalisation, by contrast, has at times proven to be a dead-end alley). The mass exodus from the countryside to the cities, now occurring in China and India, boosts productivity and incomes. Knowledge-based production is increasingly shaping the global economy. Conception and design become the source of value added; even Renault prizes itself now as a "*créateur d'automobiles*", and no longer as a mere "producer" of cars. Structural change, competition, new products, new production processes, and new marketing methods all bring advantages.

But Cohen wonders, like Pangloss in Voltaire's satirical novel *Candide*, if all really is for the best in the best of all possible worlds. Why is Cohen worried?

The reason is the Easterlin paradox, the finding, first published in 1974, that although people with higher incomes are more likely to report being happy, rising incomes do not lead to increases in subjective wellbeing. Consumption acts like a drug, providing only ephemeral pleasure. Happiness depends more on growth rates than on GDP levels: people will only be satisfied if they have more than they had yesterday–and more than their neighbour. China and India are bound to find that their growth will slow as soon as they reach the level of the rich industrial countries, if not before. Then social tensions will grow as they did in Europe in the 1970s.

Also, the battle over natural resources has intensified now that China and India have emerged. Cohen cites the example of the German Empire at the beginning of the 20th century to show that convergence by no means pacifies countries. Thus, for Cohen, the potential for military conflict has not declined with the rise of the emerging countries. As observed in Africa's conflicts, the fight for natural resources often burdens prosperity in the absence of strong, legitimate public governance.

Cohen is not preaching historical determinism, but urges diversity in approaches to economic policy. Asia does not have to repeat Europe's mistakes. Even ecological risks can be managed, especially with the help of the new cyber world. In contrast to material globalisation, the virtual world is not subject to the same laws of scarce resources, since the more people that participate in the Internet, the more it will flourish. So Cohen is pinning his hopes on the cyber world. If it does not live up to its promise, then we are left with the dark vision of the future described in the book's opening quote from singer Leonard Cohen: "Give me back the Berlin Wall. Give me Stalin and Saint Paul. I've seen the future, brother–it is murder."

Daniel Cohen, *La prospérité du vice: Une introduction (inquiète) à l'économie*, Editions Albin Michel, Paris, September 2009.

Greener aid

Climate change is very much on the development agenda, but according to this guide, *Integrating Climate Change Adaptation into Development Co-operation: Policy Guidance*, while developing countries account for over half of total carbon emissions, they are also the most vulnerable to climate change. The guide, which is aimed at donors, but is also useful for aid recipients, argues that development-as-usual may be counterproductive. For example, building new, weatherproofed roads in Africa may be good for sustainable development, but what if those roads encourage settlement along flood-endangered coasts? OECD countries donated an estimated $3.8 billion in bilateral aid to developing countries' climate change mitigation efforts in 2007. The book examines the potential impact of climate change on the Millennium Development Goals and gives examples of aid strategies that take climate change into account.

ISBN 978-92-64-05476-9

New OECD publications

Now available on www.sourceoecd.org

Complementing the Overview volume of the *African Economic Outlook 2009*, these Country Notes Volumes provide country-by-country analysis, economic projections, and an analysis of the social and political context for 47 African countries.

Some low-income countries lack the institutions, infrastructure and supply-side capacity to benefit from open markets and lift their people out of poverty. *Aid for Trade at a Glance* presents a comprehensive analysis of donor and partner country engagement, as well as country factsheets that help assess the outcomes and impacts of aid for trade.

Equally Prepared for Life finds that school students are still being held back by gender perceptions. In mathematics, boys and girls broadly do equally well at the end of primary school, but by age 15 boys tend to perform better in all but eight countries. In reading, girls do better than boys by the end of primary school and pull further ahead in secondary school.

Publications listed on these pages are available at subscribing institutions via our online library, SourceOECD, at the URLs indicated. If your institution is not a subscriber, ask your librarian to subscribe today! These publications are also available through the OECD Online Bookshop at **www.oecd.org/bookshop**

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OECD Economic Surveys: European Union 2009
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OECD Journal on Budgeting, Volume 2009, Supplement 1
This special issue of the *OECD Journal on Budgeting* focuses on Mexico.
9-Nov-2009, 106 pages, €24 $32 £20 ¥3 000
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The Future of International Migration to OECD Countries
2-Sep-2009, 285 pages, €45 $60 £38 ¥5 600
www.SourceOECD.org/9789264044494
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The 2009 edition of the *World Energy Outlook* (WEO), released on 10 November, provides updated projections that take into account the implications of the global credit crisis, the economic slowdown and the recent slump in the prices of oil and other forms of energy. It also presents in-depth analysis of three special topics: financing energy investment under a post-2012 climate framework, prospects for global natural gas markets, and energy trends in Southeast Asia.

Government at a Glance is a new, biennial publication of the OECD. It provides over 30 indicators describing key elements underlying government performance. With a focus on public administration, the publication compares the political and institutional frameworks of government across OECD countries, as well as government revenues, expenditures and employment. It also includes indicators describing government policies and practices in integrity, e-government and open government, and introduces several composite indexes summarising key aspects of public management practices in human resource management, budgeting and regulatory management.

The financial crisis left major banks crippled by toxic assets and short of capital, and led governments to intervene massively. These interventions helped to avoid systemic collapse and stabilise the global financial system. *The Financial Crisis: Reform and Exit Strategies* analyses the steps policy makers now have to take to devise exit strategies from bailout programmes and emergency measures. The agenda includes reform of financial governance to ensure a healthier balance between risk and reward, and restoring public confidence in financial markets.

OECD Factbook 2009 is the fifth edition of a comprehensive and dynamic statistical annual from the OECD containing more than 100 indicators covering a wide range of areas. This year, the *OECD Factbook* features a focus chapter on inequality. For the first time, the OECD Factbook is also available as a free iPhone app. For more information, go to appshopper.com/books/oecd-factbook-2009. It is also available on a USB key: www.oecd.org/bookshop?9789264061682.

The *OECD Model Tax Convention* is the model used by countries when preparing bilateral taxation agreements. It is periodically updated with the last update having been approved in 2008. In addition to being available in print form, the complete *OECD Model Tax Convention* is now also available on a USB Flash Memory Key. For more information on the USB key, see www.oecd.org/bookshop?9789264050884.

Highlights from Education at a Glance 2009 presents the key education indicators from *Education at a Glance 2009*. Each indicator is presented on a two-page spread. The left-hand page explains the significance of the indicator, discusses the main findings, examines key trends and provides readers with a links to further information. The right-hand page contains clearly presented charts and tables, accompanied by dynamic hyperlinks (StatLinks) that direct readers to the corresponding data in Excel® format.

TAXATION

Tax Co-operation 2009: Towards a Level Playing Field
8-Sep-2009, 355 pages, €80 $108 £68 ¥10 000
www.SourceOECD.org/9789264040632
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OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2009
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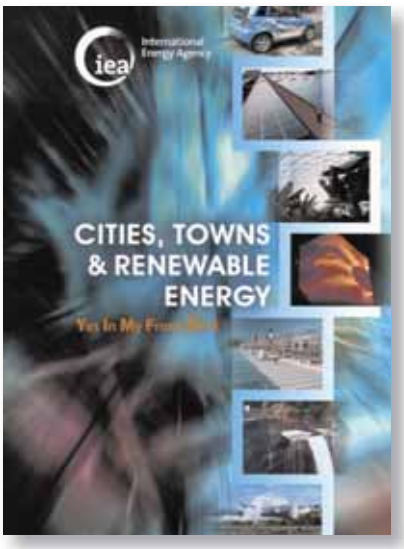
Urban energy



Despite the mitigated outcome of the recent Copenhagen climate change summit, efforts to develop renewable energy still make progress. Practical solutions to improve the development and implementation of renewable energies and boost their efficiency are constantly being sought. Attention is starting to focus on cities. Considering the fact that about half of the world's population now lives in an urban environment and produces about 70% of the world's energy-related CO_2 emissions, it is only logical that the development of renewable energy should be prioritised in cities and towns. Using the immediate environment and locally available resources, such as waste or heat from buildings, ensures that the schemes being implemented do not rely on costly national or international involvement. This also allows for local governments to improve local businesses and employment.

However, this is no easy task, as *Cities, Towns and Renewable Energy: Yes In My Front Yard* illustrates. Despite the fact that many encouraging initiatives exist in urban environments of widely varying sizes and development levels–from a megalopolis like Tokyo to a small community like Güssing, Austria–these still affect a relatively small proportion of the world's cities. Based on several case studies, this book encourages further progress by emphasising the importance of information and adequate planning. Front yards may not fill up with solar panels or wind turbines, but these efforts should nonetheless help improve attitudes towards renewable energy schemes and increase their effectiveness too.

ISBN 978-92-64-07687-7

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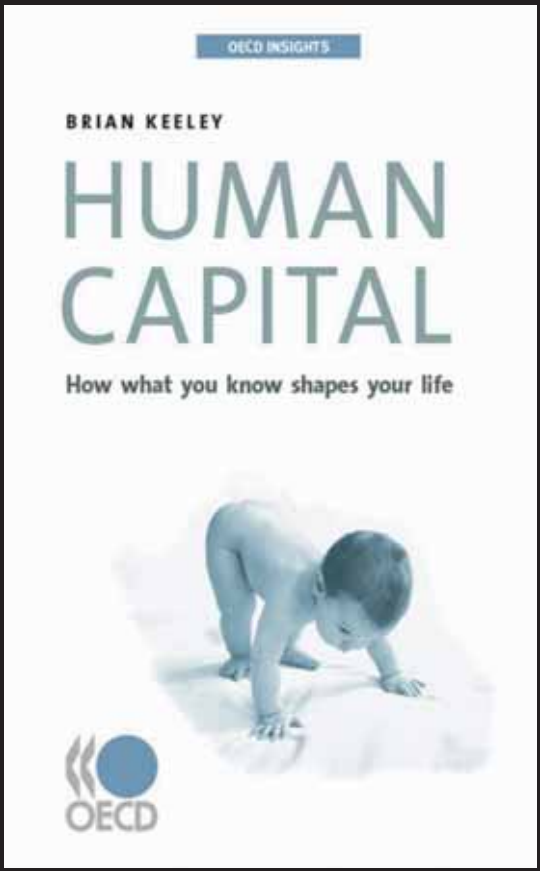

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Economic outlook **2010-2011**

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Introduction

Member countries

Non-member countries

Preparing the exit

Jørgen Elmeskov, Acting Head, Economics Department

The recovery that began earlier this year in a number of non-OECD economies has now spread to the OECD area at large. But in most OECD economies, growth is likely to fluctuate around a modest underlying rate for some time to come. It is being held back by still substantial headwinds as households, financial institutions, non-financial enterprises and, eventually, governments have to repair their balance sheets. This also means that unemployment is set to move higher and already-low inflation will be under further downward pressure. It is only some time down the line that the recovery will become sufficiently strong to begin to reduce unemployment.

The upturn in the **major non-OECD countries**, especially in Asia and particularly in China, is now a well-established source of strength for the more feeble OECD recovery. The strength of the upturn reflects both the limited direct exposure to the financial origins of the crisis and the strong policy stimulus these countries were in a position to apply. The major policy issue in many of these countries is now becoming one of withdrawal of stimulus so as to avoid igniting asset or general price inflation.

The **US economy** is recovering on the back of policy stimulus, improving financial conditions, non-OECD demand growth, normalisation of stock-building and stabilisation of the housing market. With rapid labour shedding in the downturn, employment should respond quickly to economic activity and unemployment may peak in the first half of 2010.

The **euro area** economy will benefit from many of the same growth-drivers as the United States. But work-sharing schemes which cushioned employment in the downturn may also weaken the employment intensity of growth going forward. With unemployment not set to peak before the end of 2010 or the beginning of 2011,

household confidence is likely to be weak and sap the strength of the recovery.

Japan is well positioned to benefit from strong growth in the rest of Asia but, fiscal stimulus notwithstanding, weakness on the domestic side will remain a drag on growth. With activity insufficient to materially reduce unemployment, deflation is set to linger.

The **risks** around the projection are substantial. A main risk on the downside relates to how rapidly consumers will choose to rebuild their balance sheets. The projections mostly embody saving rates remaining stable at their recent higher level, which corresponds to what should be expected based on past behaviour, but households could wish to rebuild their balance sheets more rapidly or be forced to do so by financial constraints. Conversely, the projections also embody an only modest increase in the business investment share of GDP following its recent steep fall and that could be too pessimistic. Moreover, just as the collapse in international trade propagated and intensified the downturn, its rebound may prove faster than expected, which could stimulate economic activity. Financial conditions going either way relative to the assumption behind the projections is another risk.

International imbalances, notably the US deficit and the China surplus, have narrowed appreciably during the downturn. The projections imply that this adjustment has now run its course. With imbalances remaining at levels that would have been unprecedented just a few years ago, the risk of disorderly exchange rate adjustment cannot be excluded. This underlines the importance of international efforts, recently given impetus in the context of G20, to ensure a sustainable international growth pattern.

Overall the risks around the projection may be balanced; but the same may not be the case for their consequences. With inflation being low to begin with and set to fall further in most countries, the fall-out from downside risk could be much worse. Japan's experience has shown that it is more difficult to exit than to enter deflation and that deflation makes it much harder for policy to respond to adverse shocks.

These are the rather inauspicious conditions under which governments and central banks have to consider when and how rapidly to roll back many of the measures taken in response to the crisis. Yet preparing exit strategies cannot be put off. Many of the interventions, while appropriate during the crisis, would be harmful if they stayed in place for too long. Preparing and communicating well articulated exit strategies will increase confidence that there is a way out. That in itself will allow for greater flexibility in the implementation of the strategy.

Spelling out exit strategies is also useful because many of the policies that will form part of such strategies can be expected to have international spillovers, calling for various degrees of co-ordination across countries ranging from *ex ante* information sharing to collective policy approaches. Against this background it is regrettable that so few exit strategies have so far been articulated–with, for example, less than half of OECD countries having announced medium-term fiscal consolidation programmes with a clear description of the instruments to achieve the final target.

Conventional monetary policy clearly has to reflect domestic economic circumstances, and some countries with incipient upward pressure on asset and consumer prices have indeed already begun tightening. But, on the projections in this Outlook, for the majority of OECD countries monetary policy will need to move slowly. With inflation clearly below policy objectives, policy interest rates should only be back to neutrality by the time inflationary pressures begin to be felt. The implied constellation of interest rates across countries could result in capital movements and pressure on asset prices in countries that are ahead in the cycle. Similarly, easy monetary conditions in the majority of OECD countries could risk spilling over into unjustified asset price increases. While asset price developments is a factor that needs to be taken into account by monetary policy, in general other instruments are able to influence these prices more directly and effectively.

Unconventional monetary policies have led to a large overhang of liquidity–indeed, their aim was partly to respond to increased liquidity preference and to ensure that the stability of financial institutions would not be threatened by lack of liquidity. As conditions normalise it will be necessary to absorb excess liquidity. This will call for a number of policy initiatives and it is important to spell out the game plan in this area to avoid misinterpretations of central bank actions. Likewise, the removal of funding guarantees and recent extensions of deposit guarantees needs to proceed in a well ordered manner. In the case of certain liquidity measures and guarantees, it may be better to phase out banks' use of these schemes by making it sufficiently costly, while keeping the schemes in place for some time to avoid having to reintroduce them in case of renewed instability, which could undermine confidence.

As regards extended deposit insurance, rolling it back may require international co-ordination as few countries may be willing to move ahead alone with a measure that could weaken the competitiveness of domestic banks.

Government budgets have suffered badly from the crisis and gross debt could exceed GDP on average in the OECD by 2011. Stopping the rot is clearly necessary and will call for fiscal consolidation that is substantial in most cases and drastic in some. That said, and countries facing acute

pressures aside, consolidation should not proceed at a pace that undermines the recovery. It is worth keeping in mind that with simultaneous fiscal consolidation across countries, activity will be affected not only by domestic consolidation but also, via trade linkages, by consolidation abroad. Also, with policy interest rates in many countries set to remain low for quite some time to come, monetary policy will have little room to accommodate fiscal consolidation. Flexibility in consolidation requires, however, maintaining the confidence of financial markets and of households which again requires credible communication of the commitment to consolidate over time. Early implementation of long overdue reforms to pension and health schemes could help signal such commitment–and such reforms are unlikely to have significant negative demand effects in the short term.

Fiscal consolidation will also need to be undertaken in a manner that does not amplify the effect of the crisis on potential output. That means concentrating on those spending components and sources of taxation that are least likely to undermine growth. At the same time, most structural reforms that boost potential output will also help the process of fiscal consolidation.

It is heartening that the crisis has not been accompanied by widespread government interference in non-financial markets. In particular, protectionist measures and measures aimed at hiding unemployment by permanently removing some potential job-seekers from the labour market have been rare so far. The car industry is an unfortunate exception to the general rule, however. And the measures in favour of short-time working, which have been very helpful in cushioning unemployment in the downturn, also bear monitoring lest short-time working becomes a permanent feature. Indeed, there need to be sufficient disincentives for employers and workers to make use of these schemes during normal times. At the same time, it will be crucial that labour market policies minimise the risk of unemployment becoming structural. In this environment, a particularly important set of structural reforms will be those affecting financial markets. Unwarranted build-ups of leverage, risk-taking and asset prices, as occurred before the crisis, must not be repeated. In this regard, the now officially recognised status of some banks as being too big or too interconnected to fail is an issue that needs to be addressed. Absent action to break up such banks, regulation will need to fully offset the associated incentives for risky behaviour through higher capital buffers, the use of convertible debt, living wills or other means. In turn, such measures will reduce the incentives for banks to reach systemic size. In any case, it is important that the private sector be given clear signals regarding the future regulatory and institutional landscape so that it can begin to adjust towards the new framework within which it has to operate.

Overall, unprecedented policy efforts appear to have succeeded in limiting the severity of the downturn and fostering a recovery to a degree that was largely unexpected even six months ago. It is now time to plan the exit strategy from the crisis policies, even if its implementation will be progressive. Radical policy action will be required in the years to come to restore sound macroeconomic balance, healthy growth and low unemployment. Only when that has happened will the crisis have been fully overcome. ■

Outlook summary

	2009	2010	2011
Real GDP growth			
United States	-2.5	2.5	2.8
Japan	-5.3	1.8	2.0
Euro area	-4.0	0.9	1.7
Total OECD	**-3.5**	**1.9**	**2.5**
Inflation (%)			
United States	0.2	1.4	1.2
Japan	-1.2	-0.9	-0.5
Euro area	0.2	0.9	0.7
Total OECD	**0.5**	**1.3**	**1.2**
Unemployment (% of labour force)			
United States	9.2	9.9	9.1
Japan	5.2	5.6	5.4
Euro area	9.4	10.6	10.8
Total OECD	**8.2**	**9.0**	**8.8**
Current account balance (% of GDP)			
United States	-3.0	-3.4	-3.7
Japan	2.5	2.8	2.8
Euro area	-1.1	-1.0	0.0
Total OECD	**-0.9**	**-0.8**	**-0.8**
Fiscal balance (% of GDP)			
United States	-11.2	-10.7	-9.4
Japan	-7.4	-8.2	-9.4
Euro Area	-6.1	-6.7	-6.2
Total OECD	**-8.2**	**-8.3**	**-7.6**
Short-term interest rate (%)			
United States	0.9	0.3	1.8
Japan	0.5	0.3	0.2
Euro area	1.2	0.8	1.9
World trade growth (% change)			
	-12.5	6.0	7.7

Note: Real GDP growth, inflation (measured by the increase in the consumer price index or private consumption deflator for total OECD) and world trade growth (the arithmetic average of world merchandise import and export volumes) are seasonally and working-day (except inflation) adjusted annual rates. The "fourth quarter" columns are expressed in year-on-year growth rates where appropriate and in levels otherwise. Interest rates are for the US: 3-month eurodollar desposit; Japan: 3-month certificate of deposits; euro area: 3-month interbank rate.

The cut-off date for other information used in the compilation of the projections is 16 November 2009.

Source: *OECD Economic Outlook*, No. 86, Preliminary edition, November 2009.

This article is based on the editorial of *OECD Economic Outlook* No 86, November 2009. The sign-off date was 16 November 2009. Order the full edition at www.oecd.org/bookshop

Jørgen Elmeskov was acting head of the OECD Economics Department at the time of writing and is now deputy chief economist. Pier Carlo Padoan was appointed as OECD chief economist in December (see page 5).

United States

Weak recovery

The economy is gradually coming out of a severe recession. The decline of output has ceased since the summer, though significant trouble spots remain. The risk of new large bankruptcies in the banking system has diminished, but equity capital will need to be replenished to offset financial losses. The household sector is also undergoing significant adjustment, with a sharp reduction of debt and rebuilding of assets. Sizeable macroeconomic stimulus and easing financial conditions will support growth, though it will be somewhat weaker than during past recoveries. Unemployment will decline slowly.

The Federal Reserve and the Administration must begin to withdraw the economic support as economic growth becomes self-sustaining. Gauging the appropriate timing will not be a simple task, but prolonged stimulus risks unanchoring inflation expectations and destabilising asset markets. While the need to be flexible in the face of changing economic conditions is desirable, exit strategies should nonetheless be communicated clearly.

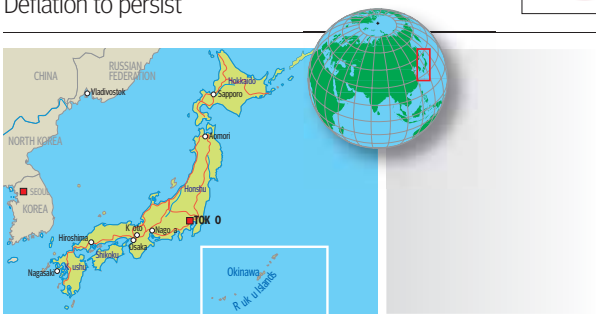
Population (000s) 2007	301 290
Area (000s sq km)	9 376
Currency	Dollar
GDP (Billion US$) 2008	14 196.5
Life expectancy at birth (Women, Men) 2006	80.7, 75.4
Total labour force (000s) 2007	154 365
Government type	Federal Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-2.5	2.5	2.8
Household savings ratio	3.9	4.0	4.0
Consumer price index	-0.4	1.7	1.3
Short-term interest rates (%)	0.9	0.3	1.8
Unemployment rate (%)	9.2	9.9	9.1
General government financial balance (% GDP)	-11.2	-10.7	-9.4
Current account balance (% GDP)	-3.0	-3.4	-3.7

Source: OECD

Japan

Deflation to persist



Population (000s) 2007	127 771
Area (000s sq km)	378
Currency	Yen
GDP (Billion US$) 2008	4 363.4
Life expectancy at birth (Women, Men) 2007	86.0, 79.2
Total labour force (000s) 2007	66 690
Government type	Constitutional Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-5.3	1.8	2.0
Household savings ratio	2.8	2.6	3.6
Consumer price index	-1.2	-0.9	-0.5
Short-term interest rates (%)	0.5	0.3	0.2
Unemployment rate (%)	5.2	5.6	5.4
General government financial balance (% GDP)	-7.4	-8.2	-9.4
Current account balance (% GDP)	2.5	2.8	2.8

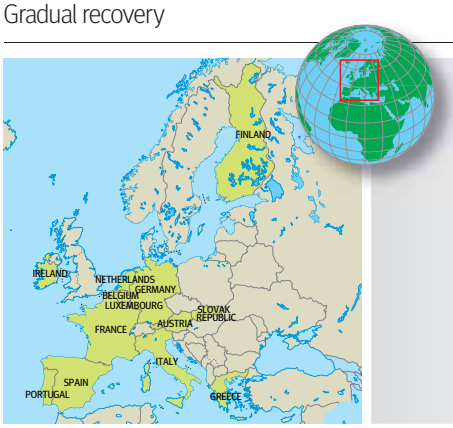
Source: OECD

The severe recession triggered by the global crisis has bottomed out, thanks in part to a rebound in exports, although production remains well below capacity. In addition, fiscal stimulus is partially offsetting the impact of falling employment and wages on domestic demand. Growth is projected to pick up gradually to around 2% in 2011, due in part to the new government's plan to increase public spending. Nevertheless, the unemployment rate is likely to stay around 5.5% through 2011 and deflation will persist.

The Bank of Japan should fight deflation through a strong commitment to keep interest rates at their very low current levels and to implement quantitative measures effectively until underlying inflation is firmly positive. Additional fiscal stimulus is not warranted given the expected pick-up in output growth, as well as Japan's large budget deficit and high public debt ratio. The government should thus finance its planned rise in public expenditure through cuts in other spending programmes. It is essential to develop a credible and detailed medium-term fiscal consolidation programme and to implement it once a recovery is firmly in place. Such a programme should include fundamental tax reform, accompanied by structural reforms, particularly in the service sector, to improve living standards in the face of a shrinking working-age population.

Euro area

Gradual recovery



Population (000s) 2008	324 650
Area (000s sq km)	2 495.8
Currency	Euro
GDP (Billion EUR) 2008	9 208.81
Life expectancy at birth (Women, Men) 2006	83.35, 77.45
Total labour force (000s) 2008	152 127

% change unless otherwise indicated	2009	2010	2011
GDP growth	-4.0	0.9	1.7
Household savings ratio	11.8	11.9	11.9
Consumer price index	0.2	0.9	0.7
Short-term interest rates (%)	1.2	0.8	1.9
Unemployment rate (%)	9.4	10.6	10.8
General government financial balance (% GDP)	-6.1	-6.7	-6.2
Current account balance (% GDP)	-0.6	-0.1	0.3

Source: OECD

The sharp contraction in euro area activity appears to have ended sooner than anticipated, with further improvements in financial conditions, fiscal stimulus measures and stabilisation of export demand. However, headwinds from financial sector deleveraging and rising unemployment suggest that the recovery will be gradual. Bank lending standards are tight, credit growth to households and firms is weak and property prices are declining in many countries. Despite the improved outlook, core inflation should continue to moderate until the end of 2010 due to substantial economic slack.

Low core inflation, tight credit conditions and a persistent negative output gap make it appropriate for the current expansionary monetary policy stance to be maintained until late 2010. Thereafter, emergency credit support measures should be withdrawn and policy rates gradually increased. Medium-term growth prospects would be enhanced by clear and credible plans for future fiscal consolidation and further structural measures to deepen the single market, enhance competitive pressures and strengthen financial supervision.

Germany

Budget to deteriorate sharply

Following the sharp decline in the first quarter of the year, real GDP increased in the second quarter, helped by the temporary surge in private consumption growth in response to stimulus measures. The recovery continued in the third quarter on account of an improvement in world trade and stock-building. Going forward, the improvement in activity could be relatively slow, especially through to mid-2010. Unemployment remains unusually low, not least due to the government-sponsored short-time working scheme which allows firms to reduce labour input without layoffs. While unemployment is projected to increase rapidly during 2010 the total employment loss will be mild compared with the depth of the recession.

The budget balance is set to deteriorate sharply in 2009 and 2010 as revenues remain subdued and expenditure rise, not least due to higher unemployment. In addition, the fiscal stimulus package will worsen the budget deficit in 2010. Once economic activity is back on a sustainable growth path, the structural deficit will have to be reduced, also in view of future ageing related expenditure. The implementation of income tax cuts in 2011 should be made conditional on the ability to meet the recently enacted fiscal rule.

Population (000s) 2007	82 257
Area (000s sq km)	357
Currency	Euro
GDP (Billion US$) 2008	2 927.3
Life expectancy at birth (Women, Men) 2006	82.4, 77.2
Total labour force (000s) 2007	41 685
Government	Federal Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-4.9	1.4	1.9
Household savings ratio	11.7	12.3	12.2
Consumer price index	0.2	1.0	0.8
Short-term interest rates (%)	1.2	0.8	1.9
Unemployment rate (%)	7.6	9.2	9.7
General government financial balance (% GDP)	-3.2	-5.3	-4.6
Current account balance (% GDP)	4.0	4.5	5.4

Source: OECD

France

Low inflation

Population (000s) 2007	61 938
Area (000s sq km)	549
Currency	Euro
GDP (Billion US$) 2008	2 140.7
Life expectancy at birth (Women, Men) 2007	84.4, 77.5
Total labour force (000s) 2007	27 702
Government	Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-2.3	1.4	1.7
Household savings ratio	13.5	13.7	13.7
Consumer price index	0.1	1.0	0.6
Short-term interest rates (%)	1.2	0.8	1.9
Unemployment rate (%)	9.1	9.9	10.1
General government financial balance (% GDP)	-8.2	-8.6	-8.0
Current account balance (% GDP)	-2.1	-2.1	-2.1

Source: OECD

After falling by 2.2% in 2009, real GDP is projected to grow slowly, by 1.4% in 2010 and 1.7% in 2011, led by business investment and exports. This will not be enough to prevent the unemployment rate from rising until the beginning of 2011, resulting in inflation of below 1% per year. Households have reacted to rising job and financial-market uncertainty by increasing their saving, offsetting the positive impacts of higher public transfers and improved terms of trade. A mix of appropriate discretionary measures and automatic stabilisers has cushioned the impact of the crisis. The investment tax cut embedded in the 2010 budget is also welcome, but additional spending should now be resisted. Designing and clearly communicating a credible multi-year exit strategy is a priority. The needed consolidation represents an opportunity to rebalance public finances by cutting inefficient spending, increasing inheritance, property and carbon taxes and further reforming the pension system.

Italy

Fiscal consolidation needed

The severe recession in Italy started earlier than elsewhere but activity rebounded in the third quarter. Improved financial conditions have helped rebuild confidence and bolster domestic demand. The saving ratio, estimated to have risen substantially in 2009, is projected to fall back only slightly; consumption will be a more significant factor in growth during 2011. Further support to exports will come from the recovery in world trade. Higher unit labour costs, despite some falls in wage costs, and the oil price upturn will moderate the decline in inflation, even as unemployment rises somewhat further.

Given high public debt, Italy did not introduce a large-scale fiscal stimulus. Nonetheless, with cyclically weak revenues, the deficit exceeds 5% of GDP and debt is set to increase to 120% of GDP by 2011. Significant fiscal consolidation efforts will thus be required from 2011 onwards, as growth picks up.

Population (000s) 2007	58 880
Area (000s sq km)	301
Currency	Euro
GDP (Billion US$) 2008	1 815.6
Life expectancy at birth (Women, Men) 2006	84.0, 78.4
Total labour force (000s) 2007	24 728
Government	Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-4.8	1.1	1.5
Household savings ratio	10.7	10.5	10.5
Consumer price index	0.7	0.9	0.8
Short-term interest rates (%)	1.2	0.8	1.9
Unemployment rate (%)	7.6	8.5	8.7
General government financial balance (% GDP)	-5.5	-5.4	-5.1
Current account balance (% GDP)	-2.7	-2.3	-2.2

Source: OECD

United Kingdom

Strong headwinds

Population (000s) 2007	60 975
Area (000s sq km)	245
Currency	Pound
GDP (Billion US$) 2008	2 211.0
Life expectancy at birth (Women, Men) 2005	81.1, 77.1
Total labour force (000s) 2007	30 721
Government	Constitutional Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-4.7	1.2	2.2
Household savings ratio	5.3	5.8	5.5
Consumer price index	2.1	1.7	0.5
Short-term interest rates (%)	1.2	0.6	1.4
Unemployment rate (%)	8.0	9.3	9.5
General government financial balance (% GDP)	-12.6	-13.3	-12.5
Current account balance (% GDP)	-2.6	-2.4	-2.0

Source: OECD

The economy is set for recovery, supported by improving financial conditions, an expansionary monetary policy and stronger international growth. However, the pick-up will be slow with GDP projected to grow by slightly more than 1% in 2010 reflecting strong headwinds from balance sheet adjustments, a still weakening labour market and fiscal tightening. In 2011 the recovery will gain momentum, but resource utilisation will remain low and the unemployment rate is projected to reach 9.5%. Inflation is likely to remain below the 2% target for an extended period.

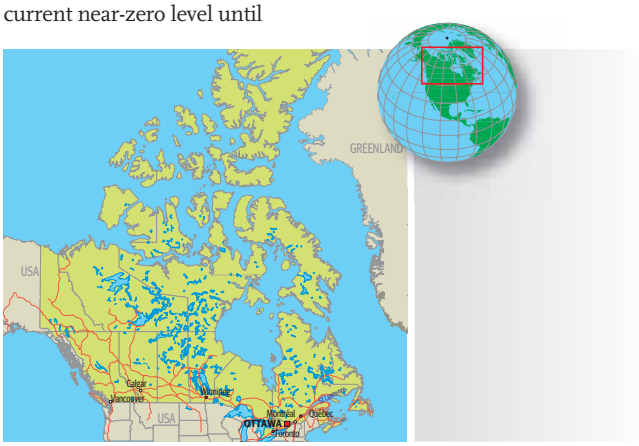
Financial sector support, monetary easing and fiscal stimulus have cushioned the downturn. While monetary policy should remain expansionary over the projection period, normalisation of interest rates will probably need to start in 2011. The weak fiscal position makes further consolidation necessary; an announcement of concrete and comprehensive consolidation plans upfront would enhance macroeconomic stability. Strengthening financial regulation and supervision would also support stability and hinder a build-up of new imbalances at historically low interest rates.

Canada

Investment rebounds

The contraction that began in the last quarter of 2008 seems to have ended in the second half of 2009. External demand and domestic investment now appear to be rebounding, but they also pose the greatest risks to the recovery's sustainability. Unemployment is projected to keep rising until the end of 2009 and underlying disinflation to continue for several more quarters under the weight of persistent slack.

The Bank of Canada should hold the policy rate at its current near-zero level until the end of June 2010, as it has committed, and probably beyond. Given the time required to roll out fiscal stimulus and the nascent recovery, additional expansionary measures, including extending the window of eligibility for extraordinary unemployment benefits, should be resisted. Instead, governments should be preparing detailed and credible medium-term fiscal consolidation plans to be announced soon and be implemented when the recovery is firmly underway.



Population (000s) 2007	32 927
Area (000s sq km)	9 976
Currency	Dollar
GDP (Billion US$) 2008	1 311.2
Life expectancy at birth (Women, Men) 2006	83.0, 78.4
Total labour force (000s) 2007	18 008
Government	Confederation

% change unless otherwise indicated	2009	2010	2011
GDP growth	-2.7	2.0	3.0
Household savings ratio	4.3	3.3	3.0
Consumer price index	0.4	1.3	1.0
Short-term interest rates (%)	0.8	0.5	1.7
Unemployment rate (%)	8.3	8.7	8.1
General government financial balance (% GDP)	-4.8	-5.2	-4.5
Current account balance (% GDP)	-2.9	-3.4	-3.4

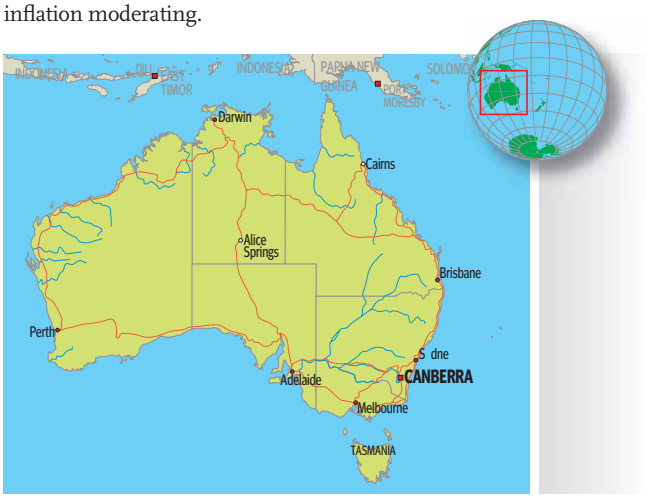
Source: OECD

Australia

Relatively robust recovery

Having been less affected by the crisis than most other OECD countries, Australia is likely to experience a relatively more robust recovery. Large public transfers and tax incentives stimulated private consumption and capital expenditure by firms. In addition, strong imports by China and other dynamic Asian economies buoyed exports of mining products. Growth is projected to pick up to 2.5% in 2010 and 3.5% in 2011, with unemployment peaking at around 6.25% in 2010 and inflation moderating.

Current economic trends and the reduction in negative macroeconomic risks argue in favour of a gradual tightening of monetary policy. Furthermore, the planned reduction of the federal budgetary stimulus seems to be an appropriate response to the needs of the economy. To maximise the positive impacts of their investment programme, the authorities should submit proposed projects more systematically to a rigorous and transparent cost-benefit analysis.



Population (000s) 2007	21 072
Area (000s sq km)	7 687
Currency	Dollar
GDP (Billion US$) 2008	803.1
Life expectancy at birth (Women, Men) 2007	83.7, 79.0
Total labour force (000s) 2007	11 000
Government	Independent Federal State, UK Monarch

% change unless otherwise indicated	2009	2010	2011
GDP growth	0.8	2.4	3.5
Household savings ratio	2.5	0.8	1.0
Consumer price index	1.6	2.4	1.8
Unemployment rate (%)	5.7	6.3	6.2
Short-term interest rates	3.4	4.4	5.4
General government financial balance (% GDP)	-4.0	-3.5	-2.6
Current account balance (% GDP)	-4.2	-4.5	-4.0

Source: OECD

Austria

Subdued inflation

Population (000s) 2007	8 315
Area (000s sq km)	84
Currency	Euro
GDP (Billion US$) 2008	320.4
Life expectancy at birth (Women, Men) 2007	82.9, 77.3
Total labour force (000s) 2007	4 213
Government	Federal Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-3.8	0.9	2.2
Household savings ratio	14.2	14.7	14.5
Consumer price index	0.3	0.6	1.0
Unemployment rate (%)	5.8	7.1	7.3
General government financial balance (% GDP)	-4.3	-5.5	-5.8
Current account balance (% GDP)	1.9	2.2	2.6

Source: OECD

In 2010, Austria is expected to recover from its worst recession in decades thanks to the improved external environment and supportive policies. If these conditions continue to prevail, growth should accelerate to its potential in 2011. Nevertheless, unemployment is set to increase until end-2010 and inflation, while inching up, will remain subdued.

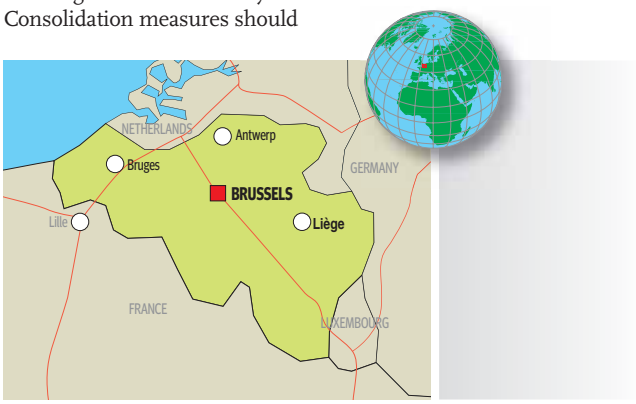
The deterioration in the fiscal position calls for committing soon to a credible medium-term consolidation strategy which should be implemented once the recovery is in train. Administrative reforms should be continued to facilitate consolidation efforts. Growth may prove stronger in the short term given the brisk improvement in the global economy. The risk of a financial crisis in Central and Eastern Europe has diminished, but rising non-performing loan ratios would put the Austrian banking sector under pressure, entailing a downside risk to fiscal projections.

Belgium

Improved confidence

The economy embarked on a slow recovery during the second half of 2009, supported by fiscal and monetary easing and an acceleration in world trade. Consumer confidence and business sentiment have improved, albeit from some of their lowest levels on record. Growth will not suffice to prevent further increases in unemployment until mid-2011, which is likely to push up the already high level of structural unemployment.

As the economy recovers, attention must return to securing fiscal sustainability. Consolidation measures should concentrate on achieving medium-term expenditure restraint at all levels of government and on controlling ageing-related costs. About two-thirds of the deficit reduction in 2010 and 2011 is to be achieved by the federal government and the social security system, and the remainder by communities and regions, although the implementation details have yet to be finalised. This should be complemented by implementing labour market reforms to increase the flexibility of wage formation and enhance job search incentives.



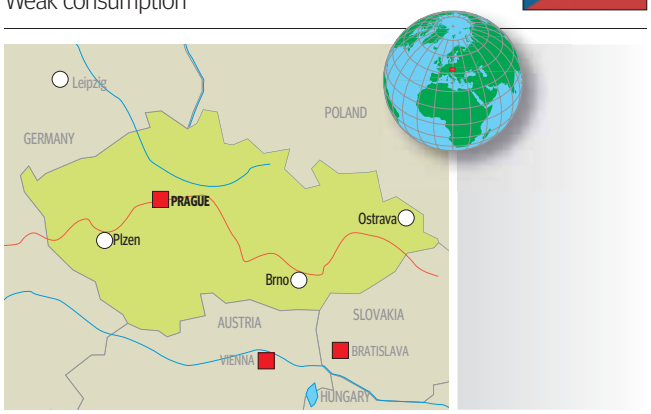
Population (000s) 2007	10 623
Area (000s sq km)	31
Currency	Euro
GDP (Billion US$) 2008	386.9
Life expectancy at birth (Women, Men) 2006	82.3, 76.6
Total labour force (000s) 2007	4 733
Government	Constitutional Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-3.1	0.8	1.7
Household savings ratio	12.7	12.2	12.0
Consumer price index	-0.1	1.0	0.9
Unemployment rate (%)	7.9	8.9	9.2
General government financial balance (% GDP)	-5.7	-5.6	-5.2
Current account balance (% GDP)	-0.8	-0.6	-0.5

Source: OECD

Czech Republic

Weak consumption



Population (000s) 2007	10 323
Area (000s sq km)	79
Currency	Koruna
GDP (Billion US$) 2008	260.0
Life expectancy at birth (Women, Men) 2006	79.9, 73.5
Total labour force (000s) 2007	5 198
Government	Parliamentary Democracy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-4.4	2.0	2.8
Consumer price index	1.1	1.4	2.0
Unemployment rate (%)	6.9	8.4	7.9
Short-term interest rates	2.2	1.9	2.4
General government financial balance (% GDP)	-5.7	-5.6	-5.0
Current account balance (% GDP)	-1.0	0.3	0.3

Source: OECD

Falling investment and recession in major export markets contributed to a sharp downturn at the beginning of this year. Real GDP turned slightly positive in the second quarter, largely due to a pick-up in exports and continued, albeit weak, consumption growth. A gradual recovery is projected for 2010 and 2011, driven by stronger investment and export demand, though weak consumption will act as a drag on growth. Inflation has been negative during part of 2009 but is expected to rise gradually to about 2% in 2011.

The government responded to the downturn with two stimulus packages and cyclical factors will further increase the general government deficit. However, there is little room for further discretionary fiscal easing and parliament has already approved a fiscal consolidation plan to reduce the government deficit. Sustaining the consolidation effort over the longer term will require addressing large unresolved spending issues, particularly in health care, welfare and pensions as part of the necessary exit strategy.

Denmark

Wide fiscal deficit

The Danish economy was hit hard, if belatedly, by the global economic crisis but is projected to recover gradually as world trade regains momentum and as support is provided by the large automatic stabilisers, substantial fiscal easing and low interest rates. Private consumption fell very steeply in late 2008 and early 2009 but less so subsequently, as it is being supported by tax cuts, withdrawals from the special pension scheme and less depressed equity prices. Sentiment is up in manufacturing and industrial production seems to have stabilised at a low level, while the number of new bankruptcies is coming down.

Despite some withdrawal of the fiscal stimulus imparted in response to the crisis, the budget deficit is expected to remain large in 2011. Additional consolidation measures will be needed in due course to bring the fiscal position back on track with the long-term targets, and these measures should be spelled out sooner rather than later.

Population (000s) 2007	5 457
Area (000s sq km)	43
Currency	Krone
GDP (Billion US$) 2008	200.0
Life expectancy at birth (Women, Men) 2006	80.7, 76.1
Total labour force (000s) 2007	2 893
Government	Constitutional Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-4.5	1.3	1.8
Household savings ratio	8.1	9.0	8.1
Consumer price index	1.3	1.4	1.6
Unemployment rate (%)	5.9	6.9	6.2
Short-term interest rates	1.9	1.3	2.4
General government financial balance (% GDP)	-2.5	-5.4	-4.0
Current account balance (% GDP)	2.5	2.1	2.1

Source: OECD

Finland

A bounce in exports

Population (000s) 2007	5 289
Area (000s sq km)	338
Currency	Euro
GDP (Billion US$) 2008	188.3
Life expectancy at birth (Women, Men) 2006	83.1, 75.9
Total labour force (000s) 2007	2 695
Government	Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-6.9	0.4	2.4
Consumer price index	1.7	1.5	1.4
Unemployment rate (%)	8.3	9.7	9.7
General government financial balance (% GDP)	-2.3	-4.8	-5.2
Current account balance (% GDP)	0.8	0.9	0.9

Source: OECD

Output continued to decline in Finland over the first half of the year, as the collapse in exports deepened. However, a recovery should get underway by the end of 2009 with a bounce in exports from the current very low levels and substantial restocking. Harmonised inflation has remained above the euro area average due to large negotiated wage increases. The unemployment rate has climbed sharply, and is expected to continue to rise, magnified by significant labour market rigidities.

The government's initial response to the downturn, including assistance to banks and businesses and a modest fiscal stimulus, provided material support to activity. Further significant fiscal loosening is planned but it may be counterproductive if it comes just as the recovery gets underway. While some consolidation measures have been announced, a coherent plan for a substantial fiscal consolidation should be articulated as soon possible, and put in place once the recovery is on a firm footing. The forthcoming wage negotiations should align outcomes more closely to productivity within firms.

Greece

Curbs on tax evasion vital

Real GDP contracted in 2009 as the effects of the global crisis gradually spread to the Greek economy. Economic activity is projected to contract somewhat further in the last quarter of 2009 and early 2010, as domestic demand continues to decelerate in the face of tight credit conditions and weak sentiment. The recent improvement in the external environment should help activity to pick up slowly, and growth could gather momentum in 2011. The unemployment rate is set to reach a double-digit level over the projection period. The current account deficit is likely to remain high.

A credible commitment to reducing fiscal imbalances on a sustainable basis is essential for restoring market confidence, creating room for future budgetary manoeuvre and meeting the rising costs of an ageing population. To achieve this, strict control of spending and curbing widespread tax evasion are vital. Long-term fiscal viability also calls for further pension and health care reforms. Increasing labour and product market flexibility will be important to achieve high rates of growth.

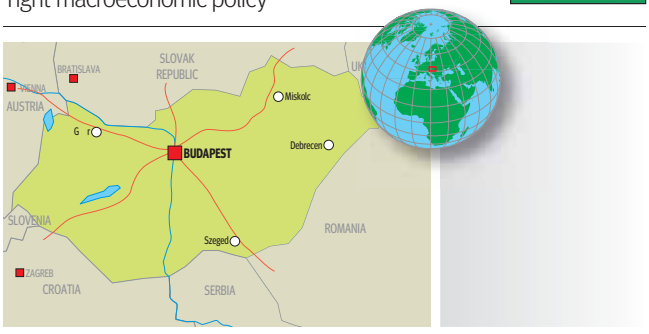
Population (000s) 2007	11 193
Area (000s sq km)	132
Currency	Euro
GDP (Billion US$) 2008	334.7
Life expectancy at birth (Women, Men) 2007	82.0, 77.0
Total labour force (000s) 2007	4 918
Government	Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-1.1	-0.7	1.6
Consumer price index	1.2	2.0	1.6
Unemployment rate (%)	9.3	10.4	10.4
General government financial balance (% GDP)	-12.7	-9.8	-10.0
Current account balance (% GDP)	-11.1	-10.0	-10.1

Source: OECD

Hungary

Tight macroeconomic policy



Population (000s) 2007	10 056
Area (000s sq km)	93
Currency	Forint
GDP (Billion US$) 2008	189.6
Life expectancy at birth (Women, Men) 2007	77.3, 69.2
Total labour force (000s) 2007	4 238
Government	Parliamentary Democracy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-6.9	-1.0	3.1
Consumer price index	4.5	4.0	3.0
Unemployment rate (%)	9.9	10.3	9.3
Short-term interest rates	8.6	6.4	7.5
General government financial balance (% GDP)	-4.3	-4.1	-3.6
Current account balance (% GDP)	-1.6	-1.8	-2.6

Source: OECD

After a sizeable contraction in 2009, GDP growth should progressively resume in 2010, and gather pace in 2011, on the back of a strengthening foreign demand and easing credit conditions. Unless the upcoming election year repeats past electoral profligacy, planned fiscal austerity should curb domestic demand. The unemployment rate will peak at over 10% in 2010 before falling slightly. The significant output gap and the recent appreciation of the exchange rate have dampened inflationary pressures, which should not increase before the recovery gains momentum.

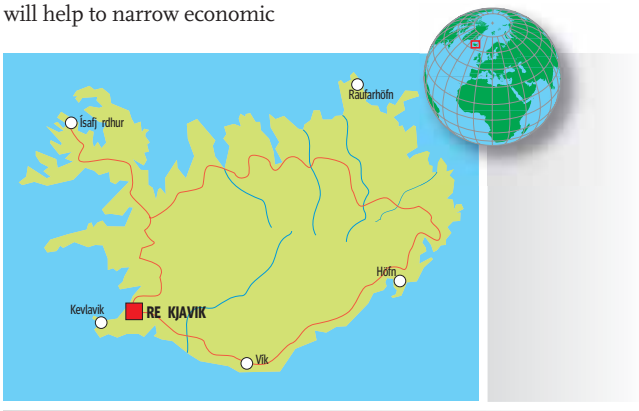
A tight macroeconomic policy under the programme of International Monetary Fund and the initial success in reining in expenditure growth have boosted investor confidence, strengthened the exchange rate and provided room for a series of interest rate cuts since mid-2009. Scope for further easing will be determined by the credibility of continued fiscal consolidation and conditions in global financial markets. To maintain investor confidence, it is crucial that the government sticks to the newly adopted medium-term fiscal framework and supports the efforts of the new fiscal council.

Iceland

Recession continues

The recession into which the Icelandic economy fell following the failure of the country's three main banks in October 2008 continues. Domestic demand has fallen sharply, and the economy is projected to continue shrinking until early 2010. Thereafter, growth is projected to return, boosted initially by the expected normalisation of financial conditions and subsequently by investment in large energy-related projects. The unemployment rate is likely to rise to around 7% by mid-2010 and edge down thereafter. The government programme will help to narrow economic imbalances, with inflation falling to about 2.5% by 2011 and the current account deficit declining to 1.5% of GDP in 2011.

It is vital that the planned fiscal consolidation programme be fully implemented so as to put public finances back on a sustainable path. Monetary policy should remain focussed on exchange rate stability and capital controls should be progressively removed as soon as feasible to normalise relations with foreign markets and allow firms to access foreign credit markets.



Population (000s) 2007	311
Area (000s sq km)	103
Currency	Krona
GDP (Billion US$) 2008	11.7
Life expectancy at birth (Women, Men) 2007	82.9, 79.4
Total labour force (000s) 2007	181
Government	Constitutional Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-7.0	-2.1	2.6
Consumer price index	11.9	5.8	2.5
Unemployment rate (%)	7.1	7.0	6.4
General government financial balance (% GDP)	-15.7	-10.1	-5.8
Short-term interest rates	11.1	7.6	6.4
Current account balance (% GDP)	-8.1	-1.6	-1.6

Source: OECD

Ireland

Prolonged adjustments

Population (000s) 2007	4 339
Area (000s sq km)	70
Currency	Euro
GDP (Billion US$) 2008	197.3
Life expectancy at birth (Women, Men) 2006	82.1, 77.3
Total labour force (000s) 2007	2 202
Government	Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-7.5	-2.3	1.0
Consumer price index	-1.7	-0.7	0.4
Unemployment rate (%)	11.9	14.0	13.8
General government financial balance (% GDP)	-12.2	-12.2	-11.6
Current account balance (% GDP)	-2.8	-2.0	-0.6

Source: OECD

The economy is experiencing a severe recession as large domestic imbalances correct, but there are recent signs that the pace of contraction is slowing. Ireland should benefit from the world trade upswing along with restored competitiveness as a result of the decline in wages and prices. The ongoing domestic adjustment will nevertheless be prolonged, and the economic recovery weak.

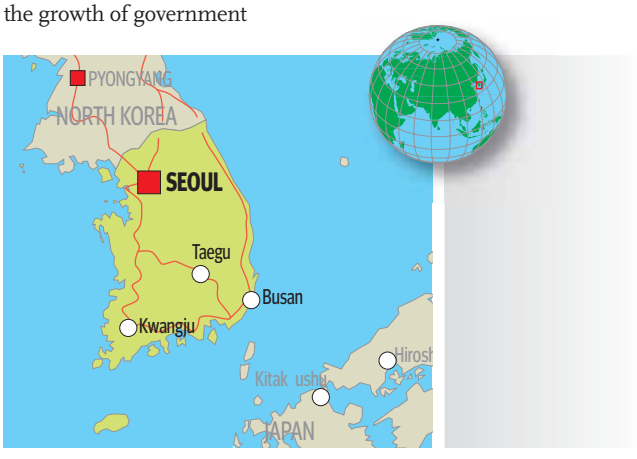
The budget deficit has swelled and public indebtedness has increased sharply. Substantial fiscal consolidation measures are already in place, but more will be needed over an extended period, which will require both further increases in revenues and cuts in public expenditure. With NAMA (the National Asset Management Agency), the government seeks to restore the banking system to health by recognising and dealing swiftly with losses, thus contributing to the recovery. This should be implemented along with the necessary risk-sharing mechanisms to protect the taxpayer.

Korea

Early and strong recovery

Following the severe contraction in late 2008, Korea has achieved one of the earliest and strongest recoveries in the OECD area, led by exports and expansionary fiscal policy. While the impact of fiscal stimulus will fade in 2010, a sustained pick-up in exports is projected to help boost output growth to 4 to 4.5% in both 2010 and 2011, with a rebound in domestic demand and a marked fall in unemployment.

As the recovery takes hold, the growth of government spending should be scaled back to bring the budget back into balance, in line with the mid-term fiscal management plan. Other exceptional measures to stabilise the economy, such as the expanded support to small and medium-sized enterprises, should be phased out. Structural reforms to enhance productivity, notably in the non-manufacturing sector, are needed to sustain growth over the medium term.



Population (000s) 2007	48 456
Area (000s sq km)	100
Currency	Won
GDP (Billion US$) 2008	1 245.7
Life expectancy at birth (Women, Men) 2007	82.7, 76.1
Total labour force (000s) 2007	24 216
Government	Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	0.1	4.4	4.2
Household savings ratio	3.9	3.0	3.2
Consumer price index	2.7	2.8	3.0
Unemployment rate (%)	3.8	3.6	3.4
Short-term interest rates	2.6	3.5	4.7
General government financial balance (% GDP)	-1.8	0.4	1.1
Current account balance (% GDP)	4.6	1.3	1.0

Source: OECD

Luxembourg

Financial services exposure

Population (000s) 2007	476
Area (000s sq km)	3
Currency	Euro
GDP (Billion US$) 2008	39.0
Life expectancy at birth (Women, Men) 2006	81.9, 76.8
Total labour force (000s) 2007	343
Government	Constitutional Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-3.9	2.4	3.4
Consumer price index	-0.1	1.6	1.0
Unemployment rate (%)	5.9	7.1	7.5
General government financial balance (% GDP)	-2.3	-4.3	-3.6
Current account balance (% GDP)	1.9	1.5	2.9

Source: OECD

The economy has been hit severely by the international financial crisis through its exposure to financial services and trade. The number of people on active labour market programmes has risen. However, the fall in output has been partially absorbed by an increase in the number of workers on reduced work time, from near zero before the crisis to 2.8% of the labour force in August. There are signs that activity has bottomed out, however, thanks to stronger equity markets and policy support. Further ahead, gradual recovery will be sustained by improving financial conditions and growth in world trade.

Further fiscal stimulus of around 1.5% of GDP has been put in place for 2010. The authorities should lay out a credible path for medium-term fiscal consolidation. Luxembourg remains highly exposed to uncertainty about international financial conditions and the improvement in world trade. The main uncertainty, however, is about the impact of the financial crisis on potential output and the long-term prospects of the economy, given its narrow specialisation in certain financial activities and types of industrial production.

Mexico

Starting to recover

Mexico has suffered its most severe recession since the 1994 currency crisis. Real GDP fell by 9.7% year-on-year in the second quarter of 2009, reflecting lower oil prices and lower exports, the outbreak of influenza and declining tourism revenues and worker remittances. Supported by the rebound in oil prices and increasing exports to the Unites States, the fall in activity slowed down and activity is now starting to recover. As monetary and fiscal stimulus are gaining traction, the recession is projected to bottom out in the third quarter of 2009 and GDP growth should rise gradually in 2010. The central bank has reduced the policy rate from 8.25 to 4.5% since February 2009 and the government implemented a fiscal stimulus package amounting to around 1.6% of GDP. Going forward, the central bank will have little room for further monetary easing as inflation is projected to remain close to the upper bound of its inflation target range. The automatic fiscal stabilisers should be allowed to work freely in 2010, but the fiscal stimulus should be gradually withdrawn if the recovery takes hold as projected. Consolidation measures proposed by the government to contain revenue shortfalls are necessary to avoid adverse financial market reactions.

Population (000s) 2007	105 791
Area (000s sq km)	1 996
Currency	Peso
GDP (Billion US$) 2008	1531.1
Life expectancy at birth (Women, Men) 2007	77.4, 72.6
Total labour force (000s) 2007	44 048
Government	Federal Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-8.0	2.7	3.9
Consumer price index	5.4	4.2	5.0
Short-term interest rates	5.5	4.9	5.8
Unemployment rate (%)	5.7	6.3	5.9
Current account balance (% GDP)	0.0	1.0	1.4

Source: OECD

Netherlands

More job losses

Population (000s) 2007	16 382
Area (000s sq km)	41
Currency	Euro
GDP (Billion US$) 2008	676.8
Life expectancy at birth (Women, Men) 2007	82.3, 78.0
Total labour force (000s) 2007	8 741
Government	Constitutional Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-4.3	0.7	2.0
Household savings ratio	10.1	10.0	9.9
Consumer price index	0.9	0.3	0.7
Unemployment rate (%)	3.7	5.2	5.5
General government financial balance (% GDP)	-4.5	-5.9	-5.3
Current account balance (% GDP)	6.3	7.2	7.7

Source: OECD

After a sharp recession, the economy looks set to grow again on the back of a recovery in world trade, fiscal stimulus and easier monetary conditions. However, growth will be too weak to prevent further increases in the unemployment rate, one of the lowest in the OECD, until the end of 2010. As companies need to restore profitability they will continue to shed workers throughout 2010. The resulting improvements in profitability should lay the foundation for renewed investment growth and hence a more durable recovery in 2011. The fiscal stimulus has contributed to a budget deficit around 4.5% of GDP in 2009. To restore fiscal sustainability, the government should pursue its consolidation plan set to start in 2011. The planned two-step increase in the retirement age will help meet this objective but would be more effective with a phased-in implementation. Further focus on active labour market policies and easing of labour protection legislation would help stimulate employment growth.

New Zealand

Finally emerging

New Zealand is finally emerging from its five-quarter long recession, the beneficiary of strong domestic and global policy stimulus. Recent indicators, notably improving business production expectations and retail sales, suggest that the third quarter is on track to register modest positive growth. But the recovery could be hampered by the overhang of high private sector indebtedness, ongoing credit contraction, the currency's recent strength and rising unemployment. Unemployment is rising markedly and, as a lagging indicator, will continue to do so. This may hold down incomes and, along with the need to unwind the burden of household debt, raise the propensity to save.

Given weak and fragile private demand, it is appropriate that monetary and fiscal policies remain expansionary for the time being. However, if the recovery takes hold as projected, stimulus should start to be withdrawn by mid-2010 in order to reinforce balance-sheet restructuring and, in conjunction with structural reforms, to steer activity toward tradeables production rather than housing investment as the main generator of income and wealth.

Population (000s) 2007	4 228
Area (000s sq km)	269
Currency	Dollar
GDP (Billion US$) 2008	115.1
Life expectancy at birth (Women, Men) 2007	82.2, 78.2
Total labour force (000s) 2007	2 245
Government	Parliamentary Democracy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-0.7	1.5	2.7
Consumer price index	2.3	2.2	1.9
Unemployment rate (%)	6.1	7.1	6.6
Short-term interest rates	3.0	2.8	4.3
General government financial balance (% GDP)	-1.2	-3.3	-3.9
Current account balance (% GDP)	-2.7	-4.4	-6.0

Source: OECD

Norway

House prices rebound

Population (000s) 2007	4 709
Area (000s sq km)	324
Currency	Krone
GDP (Billion US$) 2008	270.0
Life expectancy at birth (Women, Men) 2006	82.9, 78.2
Total labour force (000s) 2007	2 507
Government	Constitutional Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-1.4	1.3	3.2
Household savings ratio	3.3	2.0	2.0
Consumer price index	2.3	1.6	2.2
Unemployment rate (%)	3.3	3.7	3.5
Short-term interest rates	2.5	2.9	4.0
General government financial balance (% GDP)	9.6	9.9	10.8
Current account balance (% GDP)	17.4	18.6	18.1

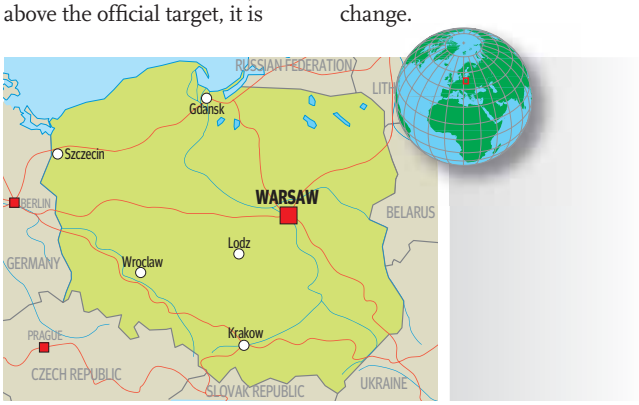
Source: OECD

Economic recovery has already started in Norway, with the large fiscal and monetary stimulus boosting consumption and sustaining employment. The rebound in house prices is a sign that this stimulus is encouraging households to spend rather than to consolidate their balance sheets. Growth in private investment will resume next year, once consumption growth is well established and credit markets return to normal. Unemployment has barely increased, partly thanks to specific government measures, but also because of a reversal of migration flows, though the size of the latter is not known with certainty. Given the large deviation from the "4% rule" in 2009 and 2010, sizeable subsequent tightening of the fiscal stance is desirable for both macroeconomic management and medium-term fiscal sustainability. Monetary policy tightening has already started and should continue for some time, as the economy recovers, the labour market tightens and inflation expectations edge up. Policies to improve public spending efficiency should be pursued further, helping fiscal consolidation for the years to come.

Poland

Growth continues

Despite the deep OECD-wide recession, the Polish economy continued to grow in 2009 due to several factors, including: monetary easing; exchange rate depreciation; relatively limited dependence on international trade; a sound banking sector and unleveraged private sector; tax cuts and other fiscal measures; and infrastructure investments linked to EU transfers and the 2012 football championship. Activity is projected to pick up, mainly driven by fixed investment, but to remain well below potential rates for some time. While headline inflation was, until recently, above the official target, it is expected to diminish steadily as economic slack increases. The general government deficit is projected to reach levels that are unprecedented since the beginning of the transition process, but no fiscal consolidation measures have been announced for 2010 by the authorities. The constitutional public debt limit of 60% of GDP is being dealt with mainly through an ambitious privatisation programme. This will nevertheless only delay the much needed consolidation of public finances until 2011. The monetary authorities should refrain from any interest-rate increases unless circumstances change.



Population (000s) 2007	38 116
Area (000s sq km)	313
Currency	Zloty
GDP (Billion US$) 2008	656.1
Life expectancy at birth (Women, Men) 2007	79.7, 71.0
Total labour force (000s) 2007	16 909
Government	Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	1.4	2.5	3.1
Consumer price index	3.5	2.2	1.9
Unemployment rate (%)	8.4	9.6	9.6
General government financial balance (% GDP)	-6.4	-7.8	-6.8
Short-term interest rates	4.3	4.2	4.2
Current account balance (% GDP)	-1.7	-2.3	-2.5

Source: OECD

Portugal

Anaemic growth

Population (000s) 2007	10 604
Area (000s sq km)	92
Currency	Euro
GDP (Billion US$) 2008	246.6
Life expectancy at birth (Women, Men) 2006	82.3, 75.5
Total labour force (000s) 2007	5 618
Government	Parliamentary Democracy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-2.8	0.8	1.5
Household savings ratio	9.6	8.9	8.8
Consumer price index	-0.9	0.7	1.0
Unemployment rate (%)	9.2	10.1	9.9
General government financial balance (% GDP)	-6.7	-7.6	-7.8
Current account balance (% GDP)	-9.7	-10.7	-11.1

Source: OECD

Growth resumed in the second quarter of 2009, but will remain subdued as private sector deleveraging constrains the recovery. As a result, unemployment is likely to increase to around 10% in 2010. The budget deficit is set to rise further in 2010 and 2011, following a substantial increase in 2009 due to the combined impact of the fiscal stimulus and the recession. Core inflation, after dropping to near zero, may increase rather slowly over the projection period.

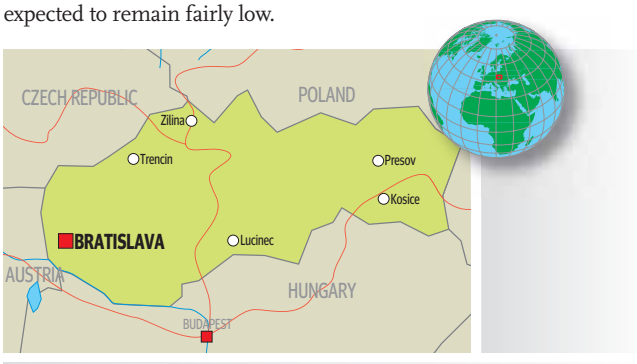
Long-standing current account imbalances, translated into rising indebtedness, limit the pace of recovery, which may be somewhat weaker than that of the euro area. Despite anaemic growth, designing and gradually implementing fiscal consolidation is a major priority. Structural reforms to promote competitiveness are key to achieving higher growth through more dynamic exports, while the pursuit of education reform should help foster longer-term potential.

Slovak Republic

Fiscal position to worsen

Economic activity rebounded in the second quarter after the sharp falls earlier on. Notwithstanding continued positive growth in the third quarter, annual GDP is expected to fall by close to 6% in 2009. Activity will gradually pick up in 2010 owing to a brighter outlook for world trade growth and a resumption of inflows of foreign direct investment, and growth should reach an annual rate of above 4% in 2011. The strong increase in unemployment is expected to gradually level off. With substantial slack in the economy, consumer price inflation is expected to remain fairly low.

The fiscal position will worsen markedly this year and next, largely due to the cyclical rise in spending on social benefits and the fall in tax revenues but also to two fiscal stimulus packages enacted earlier in 2009. In 2010, the rise in the deficit will be limited by a set of ambitious expenditure cuts. Over the medium term, further fiscal consolidation will be necessary to ensure the sustainability of public finances. While the automatic phasing-out of the stimulus measures at the end of 2010 will help in this regard, additional measures will be needed.



Population (000s) 2007	5 398
Area (000s sq km)	49
Currency	Koruna
GDP (Billion US$) 2008	115.6
Life expectancy at birth (Women, Men) 2007	78.1, 70.5
Total labour force (000s) 2007	2 649
Government	Parliamentary Democracy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-5.8	2.0	4.2
Consumer price index	1.0	1.7	2.4
Unemployment rate (%)	11.6	12.7	12.5
Short-term interest rates	1.2	0.8	1.9
General government financial balance (% GDP)	-5.9	-6.3	-5.0
Current account balance (% GDP)	-3.8	-3.1	-2.8

Source: OECD

Spain

Structural reforms needed

Population (000s) 2007	44 874
Area (000s sq km)	505
Currency	Euro
GDP (Billion US$) 2008	1 461.1
Life expectancy at birth (Women, Men) 2006	84.4, 77.7
Total labour force (000s) 2007	22 190
Government	Parliamentary Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-3.6	-0.3	0.9
Household savings ratio	17.8	17.9	17.9
Consumer price index	-0.4	0.8	-0.1
Unemployment rate (%)	18.1	19.3	19.0
General government financial balance (% GDP)	-9.6	-8.5	-7.7
Current account balance (% GDP)	-5.3	-3.8	-3.0

Source: OECD

Output is projected to fall by 3.5% in 2009 and by a further 0.25% in 2010 before recovering at a slow rate in 2011. The unemployment rate is expected to peak close to 20% in 2010. Inflation may rise temporarily in 2010, reflecting higher oil prices and projected value added tax increases, but is expected to fall to close to zero in 2011. The decline in housing transactions has levelled off and the fall in house prices has flattened.

The planned tightening of the fiscal stance should be deferred to 2011 to allow the economy to recover more firmly. However, structural reforms, including steps to curb age-related spending increases, need to be implemented to ensure long-term fiscal sustainability. Programmes to support construction of social housing should be halted: support to low-income households should be provided via means-tested cash benefits earmarked to rent payments. The effectiveness of the public employment service should be improved.

Sweden

Economic slack large

The Swedish economy has experienced a deep contraction, triggered by the global economic crisis. A gradual recovery has started but economic slack is very large and unemployment will remain high for some time. Consumer and business confidence have been improving over the past six months and retail sales have picked up. Financial market conditions have also improved, with spreads on interbank and mortgage rates having reverted towards more normal levels. Lending to households has started to accelerate, although lending to firms is still slowing.

The monetary policy stance is very stimulative and ought to remain so for the time being. Both automatic and discretionary fiscal responses will continue to support demand as will the recent measures to limit long-term unemployment. As the recovery firms up, however, fiscal consolidation efforts will be needed to reach the medium-term budget surplus target.

Population (000s) 2007	9 148
Area (000s sq km)	450
Currency	Krona
GDP (Billion US$) 2008	340.5
Life expectancy at birth (Women, Men) 2007	83.0, 78.9
Total labour force (000s) 2007	4 838
Government	Constitutional Monarchy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-4.7	2.0	3.0
Household savings ratio	14.5	14.3	12.9
Consumer price index	-0.3	1.4	3.2
Unemployment rate (%)	8.2	10.3	10.1
Short-term interest rates	0.4	0.3	1.6
General government financial balance (% GDP)	-2.0	-3.0	-2.0
Current account balance (% GDP)	7.8	8.2	8.6

Source: OECD

Switzerland

Deflation risk

Population (000s) 2007	7 551
Area (000s sq km)	41
Currency	Franc
GDP (Billion US$) 2008	319.2
Life expectancy at birth (Women, Men) 2006	84.2, 79.2
Total labour force (000s) 2007	4 573
Government	Federal Republic

% change unless otherwise indicated	2009	2010	2011
GDP growth	-1.9	0.9	1.9
Consumer price index	-0.6	0.6	0.4
Unemployment rate (%)	4.3	4.9	4.8
Short-term interest rates	0.4	0.3	1.2
General government financial balance (% GDP)	-0.7	-1.3	-1.3
Current account balance (% GDP)	8.7	10.2	10.9

Source: OECD

Positive growth is projected to resume from the end of 2009 onward, driven by growing demand from trading partners and improving activity in financial markets. Unemployment may rise to about 5% while inflation is projected to be low but positive. Leading business cycle indicators have improved markedly in recent months, turning positive from low levels in the second quarter of 2009. Orders in manufacturing have risen to a level indicating expansion in the fourth quarter. Growth is expected to pick up in 2011, reaching 2.1% at the end of the year.

Once the recovery takes hold, monetary policy stimulus will need to be withdrawn, but care will need to be taken to avoid deflation risk. While fiscal stimulus should be maintained in 2010, spending reductions need to be identified from 2011 onwards to adhere to budgetary rules.

Turkey

Moderate recovery

Output is on track for a record year-on-year decline in 2009 of 6.5%. However, four quarters of negative growth ended with a strong rebound in the second quarter of 2009. Inflation fell from 11.9% in October 2008 to 5.3% in September 2009, and the current account deficit is expected to fall from 5.5% of GDP in 2008 to around 2% in 2009. After recovering more moderately in the rest of the year, GDP is projected to expand by 3.75% in 2010 and 4.5% in 2011.

Policymakers should aim to preserve the improvement in investor confidence, which permitted a decline in risk premia and real interest rates. Making further progress in fiscal transparency is crucial in this context and the planned fiscal rule should be backed by specific consolidation measures. Structural reforms boosting the competitiveness of the business sector would help improve the performance of the economy in the upturn.

Population (000s) 2007	70 586
Area (000s sq km)	781
Currency	Lira
GDP (Billion US$) 2008	981.6
Life expectancy at birth (Women, Men) 2007	74.2, 69.3
Total labour force (000s) 2007	23 114
Government	Republican Parliamentary Democracy

% change unless otherwise indicated	2009	2010	2011
GDP growth	-6.5	3.7	4.6
Consumer price index	6.3	5.7	5.3
Short-term interest rates	10.9	7.4	6.9
Unemployment rate (%)	14.6	15.2	15.0
Current account balance (% GDP)	-1.9	-2.8	-3.3

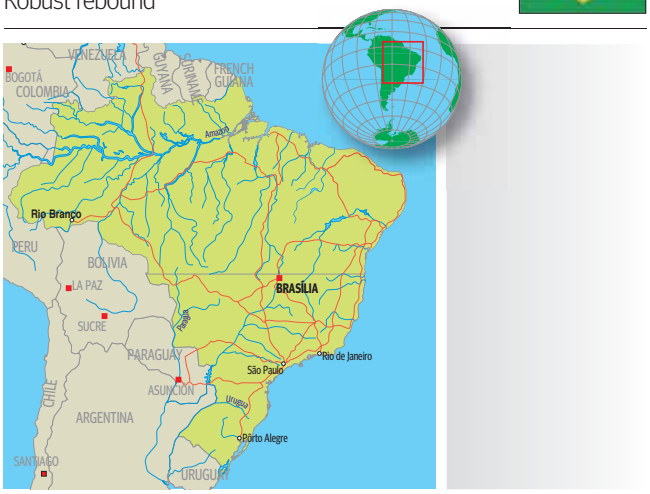
Source: OECD

Note about the OECD Observer snapshots: All GDP values in the tables are at current market prices, adjusted for purchasing power parities. Data in the lower tables come from the OECD Economic Outlook preliminary edition. For the upper tables, sources include OECD in Figures, OECD Main Economic Indicators and other sources.

Non-member countries

Brazil

Robust rebound



Population (000s) 2008	191 870
Area (000s sq km)	8 515
Currency	Réal
GDP (Billion US$) 2008	1575.3
Life expectancy at birth (Women, Men) 2007	76.5, 69
Total labour force (000s) 2007	98 846
Government type	Federal Republic

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	0.0	4.8	4.5
Inflation (CPI)	4.2	4.4	4.5
Fiscal balance (% of GDP)	-3.5	-1.7	-1.8
Primary fiscal balance (% of GDP)	1.5	3.3	3.3
Current account balance (% of GDP)	-1.4	-1.9	-2.2

Source: OECD

GDP grew in the second quarter, following a decline in the previous two. Activity rebounded robustly on the back of resilient private consumption and an ongoing recovery in industrial production, which had contracted sharply in the previous months. Capacity utilisation is approaching pre-crisis levels in a number of manufacturing sectors. Investment has nevertheless yet to recover. Domestic demand is set to grow vigorously in the last quarter of 2009 and into 2010, supported by a still accommodative policy mix. The monetary easing cycle came to an end in September, following a cumulative 500 basis-point cut in the policy interest rate over the previous 12 months. Fiscal outcomes continue to weaken due to cyclical factors, a ratcheting-up of recurrent expenditure, especially the central government payroll, and the discretionary measures that have been put in place in response to the global crisis. The end-year fiscal target is therefore unlikely to be met. A judiciously planned withdrawal of policy stimulus would be advisable from early 2010, if the recovery is well in hand, as expected.

China

Vigorous, despite weak exports

Vigorous growth has resumed in China, thanks to a very large monetary and fiscal stimulus. Momentum picked up in the second quarter and annual GDP growth is projected to exceed 8% in 2009 and 10% in 2010, before easing slightly in 2011 as the impact of the fiscal stimulus ends. The strong increase in domestic demand stemming from the stimulus has drawn in imports, while exports have been weak and may not recover to pre-crisis rates. As a result, the current account surplus is set to fall sharply to 5.5% of GDP by 2010 before rising somewhat in 2011, as domestic demand growth eases. Inflationary pressures are likely to remain subdued.

The fiscal stimulus has not endangered public finance sustainability. Indeed, starting from a sizable surplus and negative net government debt on the eve of the crisis, the government can afford to keep spending at higher levels. The composition of public spending, however, ought to be changed to favour outlays on social services, notably education, health and pensions. By contrast, credit growth will need to be reined in to avoid a renewed build-up in poor-quality loans.

Population (000s) 2008	1 328 000
Area (000s sq km)	9 597
Currency	Renminbi
GDP (Billion US$) 2008	10 310
Life expectancy at birth (Women, Men) 2007	74, 70
Total labour force (000s) 2007	782 793
Government type	Communist state

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	8.3	10.2	9.3
Inflation	-3.1	-0.2	-0.5
Consumer price index	-1.1	0.1	1.0
Fiscal balance (% of GDP)	-1.8	-0.9	-0.3
Current account balance (% of GDP)	6.4	5.4	5.9

Source: OECD

India

Strengthening momentum

Population (000s) 2008	1 148
Area (000s sq km)	3 287
Currency	Rupee
GDP (Billion US$) 2008	1 203
Life expectancy at birth (Women, Men) 2007	64.7
Total labour force (000s) 2007	446 965
Government type	Democracy

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	6.1	7.3	7.6
Inflation	2.6	5.4	5.7
Consumer price index	7.8	7.1	6.2
Short-term interest rate	4.8	6.9	7.9
Long-term interest rate	7.1	7.8	8.1
Fiscal balance (% of GDP)	-10.1	-9.0	-8.1
Current account balance (% of GDP)	-1.9	-2.0	-1.8

Source: OECD

The Indian economy has weathered the global downturn relatively well. After slowing sharply in late 2008, growth recovered during the first half of 2009 and recent high-frequency indicators suggest that momentum is strengthening. In the near term, the ongoing recovery will be only modestly hampered by poor monsoon rainfall. Growth is projected to reach over 7% in 2010 and 7.5% in 2011. Inflation has been rising since mid-2009 and is expected to remain high over the projection period.

Given the resurgence of inflationary pressures so early in the recovery, a key challenge facing policy makers is ensuring a timely withdrawal of fiscal and monetary policy stimulus. Reining in the large fiscal deficit, which has widened further in 2009, will be particularly difficult given both its magnitude and the permanent nature of recent increases in spending.

Russian Federation

Inflation on the decline

After an initial sharp rebound from the deep recession of the past year, real GDP is projected to converge towards its potential. The decline in inflation seen since early 2009 is expected to continue into 2010 before flattening out. The current account surplus will increase in 2010 as a result of terms of trade gains, but it will decline in 2011 as import growth strengthens again. Net private capital flows should strengthen, allowing a rebuilding of reserves.

Although recovery is in prospect, the large output gap and subdued inflation suggest that policy stimulus should not be removed too hastily. Fiscal policy should be managed to avoid dislocative demand effects from a surge of expenditures in late 2009 followed by a tightening in 2010. Discriminatory anti-crisis measures to protect domestic industries are counter-productive and should be unwound as quickly as possible.

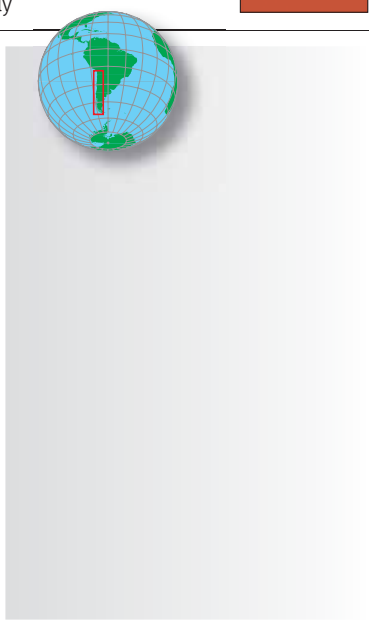
Population (000s) 2008	141 904
Area (000s sq km)	17 098
Currency	Rouble
GDP (Billion US$) 2008	2 288.4
Life expectancy at birth (Women, Men) 2007	73.9, 61.4
Total labour force (000s) 2008	75 892
Government	Federation

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	-8.7	4.9	4.2
Inflation	11.7	6.9	7.0
Fiscal balance (% of GDP)	-6.0	-4.4	-2.0
Current account balance (% of GDP)	3.6	4.1	2.5

Source: OECD

Chile

Growth to accelerate gradually



Population (000s) 2007	16 600
Area (000s sq km)	757
Currency	Peso
GDP (Billion US$) 2007	163.9
Life expectancy at birth (Women, Men) 2007	81.4, 75.4
Total labour force (000s) 2007	6 962
Government type	Representative Democracy

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	-1.8	4.1	5.0
Inflation (CPI)	1.4	1.0	2.8
Fiscal balance (% of GDP)	-3.5	-1.3	-1.0
Current account balance (% of GDP)	0.8	0.3	0.1

Source: OECD

As a small open economy with a strong dependence on mining and agricultural exports, Chile has been hit hard by the collapse in world trade and commodity prices. Output has fallen sharply and annual average growth is projected to be negative in 2009. However, a good part of the earlier fall in copper prices through end 2008 has been reversed since and activity bottomed out towards mid-year with support from a substantial macroeconomic stimulus. Growth is set to accelerate gradually through 2010 to reach rates above potential in 2011.

The central bank has reduced interest rates decisively by 775 basis points since the beginning of the year and enacted some unconventional measures when policy rates fell to 0.5% in July. The finance ministry was quick to implement a well-targeted fiscal stimulus. These measures should be gradually withdrawn if Chile embarks on the projected return to robust economic growth.

Estonia

Fiscal policy to remain tight

Real GDP is projected to fall by 14.4% this year, to broadly stabilise in 2010 and to recover in 2011, when growth of 3.9% is expected. This projection depends largely on developments in major export markets, on the speed with which resources are reallocated toward expanding export activities and on the country's ability to attract renewed foreign direct investment inflows to the export sector as the recovery takes hold.

Maintaining the currency board with a view to adopting the euro as soon as possible remains the primary objective of economic policy. The need to meet the 3% of GDP Maastricht criterion implies that fiscal policy will remain very tight. External assessments of the credibility of Estonia's economic policies–and, in particular, of its prospects for euro accession–will also be critical for foreign direct investment flows and credit conditions.

Population (000s) 2007	1 342
Area (000s sq km)	45.2
Currency	Estonian Kroon
GDP (Billion US$) 2007	20.897
Life expectancy at birth (Women, Men) 2008	78.73, 67.13
Total labour force (000s) 2007	687.4
Government type	Parliamentary Republic

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	-14.4	-0.8	3.9
Inflation (harmonised CPI)	0.0	0.1	0.4
Fiscal balance (% of GDP)	-3.0	-3.0	-2.2

Source: OECD

Indonesia

Consumption drives growth

Population (000s) 2008	228 523
Area (000s sq km)	1 919
Currency	Rupiah
GDP (Billion US$) 2008	510.8
Life expectancy at birth (Women, Men) 2007	72.6, 68.7
Total labour force (000s) 2008	111 480
Government type	Republic

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	4.5	5.3	5.6
Inflation	4.0	5.5	5.5
Fiscal balance (% of GDP)	-1.8	-1.1	-0.9
Current account balance ($ billion)	4.9	4.0	1.7
Current account balance (% of GDP)	0.9	0.6	0.2

Source: OECD

GDP growth picked up significantly in the second and third quarters of 2009. Private consumption was the main driver. Investment rebounded strongly in the third quarter, but it continues to suffer from a dearth of credit. Exports are growing faster than imports, sustaining the trade and external current account surpluses. Inflation fell rapidly in the first semester. Activity is projected to gather some further impetus, buoyed by rising investment and easing credit conditions.

The monetary easing cycle appropriately came to an end in September. Interest rate cuts and the liquidity-enhancing measures put in place earlier in the year in response to the global crisis have eased pressure on the interbank market. Implementation of fiscal stimulus is being delayed by capacity bottlenecks. But, given that the recovery appears to have begun in earnest, additional fiscal easing would not be advisable.

Israel

Tax cuts untimely

Positive growth in the second quarter of 2009, albeit slight, has marked the start of recovery. Expectation of indirect tax increases prompted a burst in car sales. Also, government spending increased rapidly, reflecting a pick-up from previously constrained expenditure. Growth rates of non-durable consumption, investment and exports all turned positive. Economic activity is expected to pick up throughout the projection period. Underlying inflationary pressures are likely to remain muted, but the risks are on the upside.

The latest government budget limited the rise in the deficit but relied excessively on short-term measures to achieve deficit and spending goals, and scheduled cuts in corporate and personal taxation for 2010 are untimely. The Bank of Israel has moved early towards a less expansionary stance, but its continued foreign-exchange interventions risk bringing additional inflationary pressures and damaging policy credibility and coherence.

Population (000s) 2008	7 309
Area (000s sq km)	22.1
Currency	New Israeli shekel
GDP (Billion US$) 2008	202.8
Life expectancy at birth (Women, Men) 2007	83.3, 79.1
Total labour force (000s) 2008	2 954
Government type	Parliamentary democracy

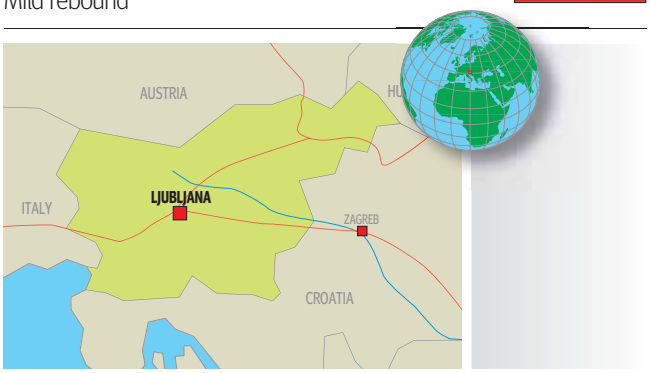
Note: For technical reasons, this table uses Israel's official statistics, which include data relating to the Golan Heights, East Jerusalem and Israeli settlements in the West Bank

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	0.0	2.2	3.3
Inflation	3.4	3.3	1.7
Fiscal balance (% of GDP)	-5.9	-4.9	-3.9
Current account balance (% of GDP)	2.9	1.9	2.0

Source: OECD and Israeli Central Bureau of Statistics

Slovenia

Mild rebound



Population (000s) 2008	2 040
Area (000s sq km)	20.3
Currency	Euro
GDP (Billion EUR) 2008	37.2
Life expectancy at birth (Women, Men) 2007	81.8, 74.6
Total labour force (000s) 2008	1 042
Government type	Republic

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	-7.9	2.7	3.0
Inflation (CPI)	0.7	1.1	2.7
Fiscal balance (% of GDP)	-7.7	-5.5	-3.0

Source: OECD

Although Slovenia moved out of recession already in the second quarter of 2009, the precipitous decline in the previous two quarters was severe enough to give a year-on-year output fall in 2009 of close to 8%. A mild rebound has been occurring and is expected to continue through 2010, driven by external demand, before growth strengthens further in 2011 on the back of stronger investment. Inflation should remain moderate due to the negative output gap and high unemployment.

Private consumption will be adversely affected by rising unemployment but should progressively recover with more dynamic wage developments in the private sector at the end of the projection period.

Following the strong 2009 fiscal stimulus, the fiscal stance is set to tighten in 2010 and 2011 given the need for consolidation. A new pension reform should bolster fiscal consolidation while labour market reforms to increase flexibility should help speed up employment recovery.

South Africa

World Cup boost

Real GDP growth will be negative in 2009, but should turn positive in the fourth quarter and accelerate in the first half of 2010, boosted by the soccer World Cup. Inflation should return to the target range in 2010 aided by a substantial output gap and the feed through of past rand appreciation. The current account deficit will narrow this year but should widen thereafter as imports outpace exports.

Given the fragile nature of the recovery, the planned increase in public spending in 2010 should be implemented. It must, however, remain cast within a medium-term framework consistent with debt sustainability, which is likely to imply substantial spending restraint in the coming cyclical upswing. The downturn and the attendant large deficits have also made it more urgent to increase the efficiency of public expenditure.

Population (000s) 2008	48 687
Area (000s sq km)	1 221
Currency	Rand
GDP (Billion US$) 2008	492.2
Life expectancy at birth (Women, Men) 2007	52, 49
Total labour force (000s) 2008	17788
Government type	Republic

% change unless otherwise indicated	2009	2010	2011
Real GDP growth	-2.2	2.7	4.5
Inflation	7.3	6.1	5.2
Fiscal balance (% of GDP)	-7.3	-5.3	-3.5
Current account balance (% of GDP)	-4.9	-5.7	-6.0

Source: OECD

Ireland's outlook

Sebastian Barnes, OECD Economics Department

Ireland was the fastest growing OECD economy since the mid-1990s. It is now experiencing one of its most severe recessions. What explains this turnaround? How will the Irish economy recover?

The past year and a half have been difficult for the global economy, though few OECD countries have felt the chill of crisis as much as Ireland. In just a few years the country has gone from being what many viewed as a model of fast growth and confident prosperity to an economy mired in recession and burdened by uncertainty.

How times have changed, for the economic performance of Ireland since the mid-1990s had been remarkable: GDP per capita growth averaged close to 5% from 1995 to 2007. Over a decade, living standards increased by one-third. Employment growth was spectacular and drew in large numbers of foreign-born workers. Irish people who had emigrated in earlier years came home, and there was for the first time large-scale inward migration: within the space of a few years, workers from the then EU accession countries, such as Poland, rose to 8% of the labour force.

This pace of growth is virtually unprecedented in the experience of OECD countries. Ireland looked and felt like a different place from the one economists had taken to describe as the "sick man of Europe" in the 1980s. Indeed, with the economy developing at a speed more familiar to emerging countries, Ireland was now dubbed the Celtic Tiger.

Other OECD countries inevitably looked to the Irish experience to see what could be learned to boost their growth performance. How did Ireland manage to raise living standards so fast?

There is no single explanation, though the ability to attract foreign direct investment (FDI) was a key driver. The stock of inward FDI now comes to around 80% of national income, and foreign-owned companies account for the majority of exports and a substantial share of employment. Multinationals were attracted by the open, flexible and market-oriented

Dublin's International Financial Services Centre

©Luke MacGregor/Reuters

economy. Favourable taxation and a skilled English-speaking workforce also helped. Membership of the European Union, including monetary union and the single market, was crucial. The emergence of sectors such as information and communications technologies, pharmaceuticals and international financial services, were particularly suited to this small, open and dynamic economy. But while this was good timing, it is quite clear that Ireland's success did not come overnight, but emerged from effort over many years by policymakers, business people and other social partners to put Ireland's house in order and create a good framework for business, investment and job growth.

The increase in living standards was the reward for good decisions taken in those earlier years. Secondary school was only made free in Ireland in the late 1960s, leading to a belated but large increase in educational attainment. While this investment in human capital did not show returns during the period of weak macroeconomic performance in the 1980s, there was a large latent potential for higher productivity, whose benefits were reaped from the mid-1990s. In fact, foreign companies continue to appreciate Ireland's young and well-educated workforce. The economy had developed resilience too.

While the Irish economy slowed around 2000 as the "dotcom" bubble burst, GDP never actually contracted in annual terms, unlike in several other OECD countries, and unemployment rose only marginally. A strong recovery followed, with GDP growth averaging over 5% from 2002 to 2007.

So, why did it all end? Today, Ireland is experiencing one of the most severe recessions of OECD countries. The peak-to-trough fall in gross national product is likely to be close to 13%, according to OECD forecasts. The unemployment rate has risen from just over 4% to 13% in less than two years. How did the situation deteriorate so quickly?

One clue is that the most recent years of expansion were driven much more by domestic demand than in the years running up to 2000. Exports, which had expanded at a lively rate, grew more slowly. Productivity growth slowed sharply too, while inflation, wages and labour costs increased more rapidly. In short, Ireland was losing competitiveness, and the current account deficit was growing.

The property market was at the heart of this new surge in demand: house prices at the peak were around four times higher in real terms than in 1995. While house prices had been low in the mid-1990s, and demand for

housing was pushed up by rising incomes and a growing population, a decade later prices had reached unsustainable levels. What is more, those house prices were driven up by rising credit, with total borrowing soaring by an average annual rate of 20% during the most recent years. Commercial property was also surging, with retail rental values in Dublin's Grafton Street soon being ranked among the most expensive in the world, alongside the likes of Fifth Avenue, Bond Street and the Champs Elysées.

The property boom had a major effect on the whole Irish economy. House-building reached 13% of national income, a larger share even than in Spain, and drew in vast numbers of workers. Consumption was supported by rising property wealth. Banks were lending money at a fast pace, and property-related loans became a large part of their overall exposures.

House prices peaked in 2007. Prices have since dropped by 25% and further falls are likely. As the property market turned, economic activity began to slow with sharp falls in house-building. It was always going to be difficult to rebalance the Irish economy from construction towards exports and a more sustainable level of demand. But the international financial crisis made such a correction even harder to achieve by shrinking export markets and adding further pressures on the financial system. The result has been a dramatic fall in demand, with the economy facing one of its sharpest contractions in activity in decades.

How will the Irish economy recover? There have been few policy levers available to support demand. As a small country within the euro area, cuts in interest rates and monetary support measures by the European Central Bank have helped, but can only go so far. Tackling large losses in the banking system has had to be the priority to avoid systemic financial collapse. The National Asset Management Agency (NAMA), together with other measures, is designed to clean up the wounded banking system by taking a portfolio of crisis-stricken property-related assets valued at 40% of gross national income off bank balance sheets.

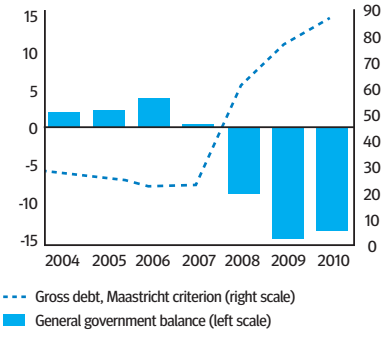
While other countries have launched fiscal stimulus packages, the Irish budget balance swung from a surplus in 2007 into a deficit that will be close to 12% of GDP this year, reflecting over-reliance on property-related revenues. This level of government borrowing is already playing an important role in supporting spending, but has meant that there was no room to ease fiscal policy further. Indeed, the dire situation has forced a tightening of fiscal policy to date of around 7.5% of national income, and further budgetary consolidation measures are planned in the coming years.

This policy constraint means that much of the recovery will need to come through adjustment in the private economy, both households and business. In particular, Ireland's high prices need to fall to restore its competitiveness in international markets. This is already happening: the harmonised index of consumer prices fell by almost 3% in the year to November 2009. Remarkably, nominal wages are being cut, with anecdotal evidence pointing to widespread reductions of 5-10%. Such wage deflation is without precedent in Ireland and in the historical experience of OECD countries. This shows how flexible the Irish labour market can be, and suggests that the economy is adjusting very rapidly. However, there are risks associated with such deflation, particularly as falling incomes will make it harder to ease the burden of outstanding debts.

But while there are signs of positive economic adjustment, the downturn is likely to continue for some time, and the OECD forecasts the recovery to be slow. One key economic and social question is whether policies can be put in place to stop the high rate of unemployment becoming permanent. With deflation, social benefit payments will need to fall in cash terms just to keep the same real value, compared with the cost of living. At the same time, for workers on low earnings, unemployment benefits are reaching temptingly high levels compared with wages. Together with weaknesses in activation programmes for people out of work, there is a real risk that unemployment could indeed become permanently high unless policies adjust to provide stronger encouragement to return to work as the economy recovers.

Price of crisis

Ireland's fiscal deterioration (general government and gross debt), % GDP, 2004-2010*



* The balance includes additional fiscal measures outlined by the authorities for 2010 in the April 2009 Supplementary Budget.

Source: *OECD Economic Outlook Database* and provisional update to June 2009 Economic Outlook 85 projections.

StatLink http://dx.doi.org/10.1787/732183113706

After the vigorous expansion of the past and the severe downturn, many are left wondering where Ireland will go next. This is particularly true for younger Irish people who had never experienced a recession until now.

Ireland should be able to sustain high living standards in the future because of its skilled labour force and open, market-friendly economy. Foreign companies have largely maintained their position in Ireland, and clusters of expertise are growing in areas such as finance and life sciences. But incomes are likely to be permanently lower than anticipated as the result of the economic contraction and necessary fiscal consolidation. While the evidence shows that the expansion in recent years could not be sustained, fostering a new period of strong and sustained growth in the coming years will be a challenge. Much will depend on learning the lessons of the past two decades.

OECD (2009), *Economic Survey of Ireland*, November, Paris.

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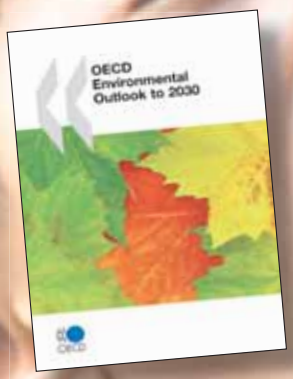

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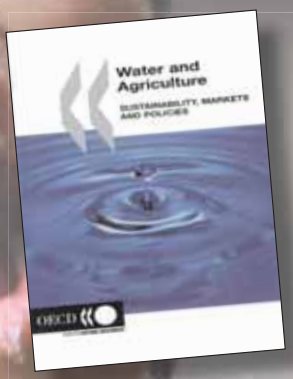

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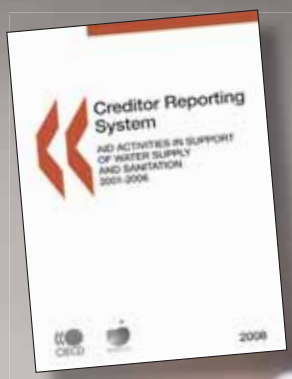

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OECD

No urge to merge

International mergers and acquisitions have registered a decline of 56% in 2009 over 2008, latest estimates show. This is the largest year-on-year decline in recent history. Much of this decline was due to the 60% plunge in M&A activity by firms based in the OECD area, from over $1 trillion to $454 billion. But major emerging economies, which enjoyed strong international investment performance in 2008, also suffered their first sharp declines in 2009 with respect to both outward and inward M&As.

Between 2007 and 2008, international M&A activity by firms based in Brazil, China, India, Indonesia, Russia, and South Africa increased by 30%, from $96 billion to $121 billion. Between 2008 and 2009, this activity fell by 62% to $46 billion. And while M&A activity into these countries increased by 5% between 2007 and 2008, it is forecast to have fallen by almost 40% in 2009.

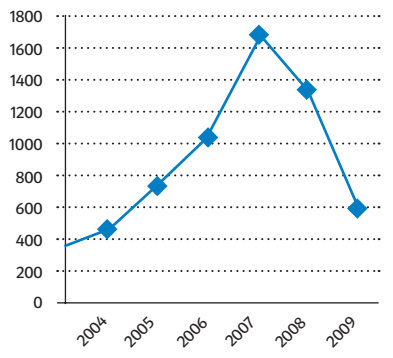
Nor could the slight improvement in foreign direct investment in the second quarter, as reported by OECD countries, be sustained. Indeed, despite that slight uptick, inflows and outflows of FDI for the first half of 2009 were both down by over 40% over the first half of 2008.

The current trend supports the OECD's forecast for sharp declines in both FDI inflows and outflows during 2009, with inflows likely to have tumbled to $600 billion and outflows to have dipped possibly below $1 trillion.

See also www.oecd.org/investment

Mergers and acquisitions

2009 forecast based on completed international M&A through 26 November 2009, US$ billions



Source: Dealogic

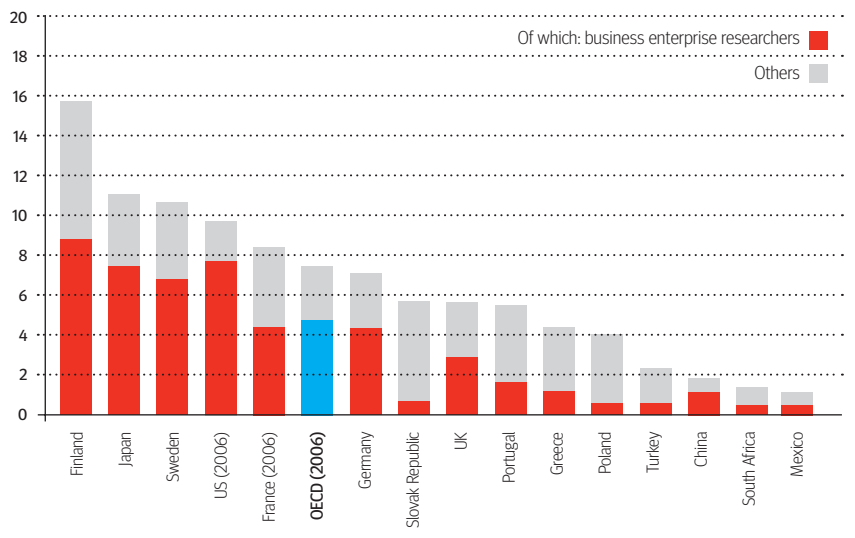
Watch the knowledge base

Just like R&D, researchers are vulnerable to economic downturns. R&D in industry is closely linked to creating new products and production techniques and to a country's innovation effort. In 2006, before the current recession hit the global economy, around 2.6 million researchers, or about 65% of all researchers, including those in the government and education sectors, were employed by businesses in the OECD area. However, whereas four out of five researchers work in businesses in the US and two out of three in Japan, only one out of two do so in the EU. Business researchers exceed 10 per 1,000 employees in Finland, Sweden, Japan and the US; they number six per 1,000 in France and Germany, and four per 1,000 in the UK. Mexico, Turkey, Poland and the Slovak Republic have fewer than one researcher per 1,000 employees in industry.

A few countries reported growth in the number of business researchers in recent years. Greece, Portugal and Turkey reported annual growth rates of more than 12% between 1997 and 2007, while China and South Africa reported rates of 15% and 19%, respectively, during the early 2000s.

Researchers, 2007

Per 1,000 total employment



Source: OECD, R&D database, May 2009

StatLink http://dx.doi.org/10.1787/742515411553

The trouble is, these numbers date from before the economic slump. Any decline, if not reversed, would augur badly for strengthening long-term growth.

OECD Science, Technology and Industry Scoreboard 2009, available at www.oecd.org/bookshop, ISBN 978-92-64-06371-6

			% change from: previous period	% change from: previous year			level: current period	level: same period last year
Australia	Gross domestic product	Q2 09	0.6	0.6	Current balance	Q2 09	-10.13	-14.45
	Leading indicator	Nov. 09	0.6	0.5	Unemployment rate	Nov. 09	5.7	4.5
	Consumer price index	Q3 09	1.0	1.3	Interest rate	Nov. 09	3.95	4.76
Austria	Gross domestic product	Q3 09	0.5	-3.7	Current balance	Q3 09	2.53	4.62
	Leading indicator	Nov. 09	0.8	5.4	Unemployment rate	Oct. 09	4.7	4.0
	Consumer price index	Nov. 09	0.2	0.7	Interest rate		..	..
Belgium	Gross domestic product	Q3 09	0.5	-3.4	Current balance	Q3 09	0.73	-4.52
	Leading indicator	Nov. 09	1.4	7.6	Unemployment rate	Oct. 09	8.1	7.0
	Consumer price index	Dec. 09	0.2	0.3	Interest rate		..	..
Canada	Gross domestic product	Q3 09	0.1	-3.2	Current balance	Q3 09	-11.95	3.12
	Leading indicator	Nov. 09	1.0	9.4	Unemployment rate	Nov. 09	8.5	6.4
	Consumer price index	Nov. 09	0.5	1.0	Interest rate	Dec. 09	0.38	2.32
Czech Republic	Gross domestic product	Q3 09	0.8	-4.1	Current balance	Q3 09	-7.48	-1.22
	Leading indicator	Nov. 09	0.2	-4.4	Unemployment rate	Oct. 09	7.1	4.4
	Consumer price index	Nov. 09	0.2	0.5	Interest rate	Dec. 09	1.64	3.89
Denmark	Gross domestic product	Q3 09	0.6	-5.4	Current balance	Q2 09	1.58	2.01
	Leading indicator	Nov. 09	0.6	5.4	Unemployment rate	Oct. 09	6.9	3.6
	Consumer price index	Nov. 09	0.0	1.3	Interest rate	Dec. 09	0.95	4.79
Finland	Gross domestic product	Q3 09	0.3	-8.8	Current balance	Oct. 09	2.42	0.83
	Leading indicator	Nov. 09	0.9	13.0	Unemployment rate	Oct. 09	8.7	6.6
	Consumer price index	Nov. 09	0.1	-0.9	Interest rate		..	..
France	Gross domestic product	Q3 09	0.3	-2.3	Current balance	Oct. 09	-6.61	-6.13
	Leading indicator	Nov. 09	1.2	11.9	Unemployment rate	Oct. 09	10.1	8.1
	Consumer price index	Nov. 09	0.1	0.4	Interest rate		..	..
Germany	Gross domestic product	Q3 09	0.7	-4.8	Current balance	Q3 09	44.41	60.37
	Leading indicator	Nov. 09	1.4	12.3	Unemployment rate	Oct. 09	7.5	7.1
	Consumer price index	Nov. 09	-0.1	0.4	Interest rate		..	..
Greece	Gross domestic product	Q3 09	-0.4	-1.7	Current balance	Oct. 09	-3.41	-4.69
	Leading indicator	Nov. 09	0.2	1.2	Unemployment rate	June 09	9.2	7.5
	Consumer price index	Nov. 09	0.5	2.0	Interest rate		..	..
Hungary	Gross domestic product	Q3 09	-1.8	-7.9	Current balance	Q3 09	1.20	-3.17
	Leading indicator	Nov. 09	0.6	8.6	Unemployment rate	Oct. 09	9.9	7.8
	Consumer price index	Nov. 09	0.3	5.3	Interest rate	Dec. 09	5.96	9.71
Iceland	Gross domestic product	Q3 09	-5.7	-8.0	Current balance	Q3 09	-0.26	1.42
	Leading indicator		..	..	Unemployment rate		..	..
	Consumer price index	Dec. 09	0.5	7.5	Interest rate	Nov. 09	8.70	18.57
Ireland	Gross domestic product	Q3 09	0.3	-7.6	Current balance	Q3 09	-2.10	-4.05
	Leading indicator	May 08	-0.8	-6.9	Unemployment rate	Oct. 09	12.8	7.2
	Consumer price index	Nov. 09	0.0	-5.7	Interest rate		..	..
Italy	Gross domestic product	Q3 09	0.6	-4.6	Current balance	July 09	-2.41	-5.96
	Leading indicator	Nov. 09	0.9	13.8	Unemployment rate	Oct. 09	8.0	7.0
	Consumer price index	Dec. 09	0.2	1.0	Interest rate		..	..
Japan	Gross domestic product	Q3 09	0.3	-4.7	Current balance	Oct. 09	15.24	10.59
	Leading indicator	Nov. 09	1.2	5.4	Unemployment rate	Nov. 09	5.2	4.0
	Consumer price index	Nov. 09	-0.2	-1.9	Interest rate	Nov. 09	0.23	0.79
Korea	Gross domestic product	Q3 09	3.2	0.7	Current balance	Oct. 09	3.43	3.46
	Leading indicator	Nov. 09	0.0	11.2	Unemployment rate	Nov. 09	3.5	3.2
	Consumer price index	Dec. 09	0.4	2.8	Interest rate	Dec. 09	2.82	4.68
Luxembourg	Gross domestic product	Q3 09	4.2	-2.6	Current balance	Q3 09	1.44	0.51
	Leading indicator	Nov. 09	1.4	10.0	Unemployment rate	Oct. 09	6.6	5.1
	Consumer price index	Dec. 09	-0.1	1.8	Interest rate		..	..
Mexico	Gross domestic product	Q3 09	2.9	-6.3	Current balance	Q3 09	-1.54	-3.93
	Leading indicator	Nov. 09	0.4	13.2	Unemployment rate	Oct. 09	5.8	4.0
	Consumer price index	Nov. 09	0.5	3.9	Interest rate	Dec. 09	4.60	8.20
Netherlands	Gross domestic product	Q3 09	0.5	-4.0	Current balance	Q3 09	12.95	14.36
	Leading indicator	Nov. 09	1.3	6.1	Unemployment rate	Oct. 09	3.7	2.7
	Consumer price index	Dec. 09	-0.6	1.1	Interest rate		..	..
New Zealand	Gross domestic product	Q3 09	0.2	-0.7	Current balance	Q3 09	0.23	-2.84
	Leading indicator	Sep. 09	0.6	4.9	Unemployment rate	Q3 09	6.5	4.3
	Consumer price index	Q3 09	1.3	1.7	Interest rate	Dec. 09	2.78	5.23

			% change from: previous period	% change from: previous year			level: current period	level: same period last year
Norway	Gross domestic product	Q3 09	0.9	-0.7	Current balance	Q3 09	13.47	20.65
	Leading indicator	Nov. 09	0.2	1.2	Unemployment rate	Sept. 09	3.1	2.5
	Consumer price index	Nov. 09	0.3	1.5	Interest rate	Dec. 09	2.08	4.64
Poland	Gross domestic product	Q3 09	0.5	1.0	Current balance	Oct. 09	-1.23	-1.95
	Leading indicator	Nov. 09	0.6	4.0	Unemployment rate	Oct. 09	8.4	6.7
	Consumer price index	Nov. 09	0.3	3.6	Interest rate	Nov. 09	4.19	6.56
Portugal	Gross domestic product	Q3 09	0.7	-2.5	Current balance	Sept. 09	-1.46	-2.39
	Leading indicator	Nov. 09	1.0	4.7	Unemployment rate	Oct. 09	10.2	7.8
	Consumer price index	Nov. 09	0.2	-0.6	Interest rate		..	..
*Slovak Republic	Gross domestic product	Q3 09	1.6	-5.0	Current balance	Q2 09	-0.30	-1.86
	Leading indicator	Nov. 09	1.1	11.5	Unemployment rate	Oct. 09	12.2	9.0
	Consumer price index	Nov. 09	0.2	0.4	Interest rate		..	..
Spain	Gross domestic product	Q3 09	-0.3	-4.0	Current balance	Oct. 09	-7.04	-11.26
	Leading indicator	Nov. 09	1.1	10.2	Unemployment rate	Oct. 09	19.3	13.2
	Consumer price index	Nov. 09	0.5	0.3	Interest rate		..	..
Sweden	Gross domestic product	Q3 09	0.2	-5.2	Current balance	Q3 09	7.09	12.92
	Leading indicator	Nov. 09	1.4	4.1	Unemployment rate	Oct. 09	8.8	6.6
	Consumer price index	Nov. 09	0.0	-0.7	Interest rate	Dec. 09	0.17	1.82
Switzerland	Gross domestic product	Q3 09	0.3	-1.5	Current balance	Q3 09	10.28	-5.59
	Leading indicator	Nov. 09	0.9	7.5	Unemployment rate	Q3 09	4.6	3.5
	Consumer price index	Nov. 09	0.2	0.0	Interest rate	Dec. 09	0.25	0.66
Turkey	Gross domestic product	Q3 09	1.8	-3.5	Current balance	Q3 09	-5.09	-11.33
	Leading indicator	Nov. 09	-0.2	11.7	Unemployment rate	June 09	13.2	9.0
	Consumer price index	Nov. 09	1.3	5.5	Interest rate	Apri. 08	16.65	17.86
United Kingdom	Gross domestic product	Q3 09	-0.2	-5.1	Current balance	Q3 09	-7.72	-14.82
	Leading indicator	Nov. 09	1.2	10.7	Unemployment rate	Aug. 09	7.8	5.9
	Consumer price index	Nov. 09	0.3	1.9	Interest rate	Dec. 09	0.61	3.21
United States	Gross domestic product	Q3 09	0.6	-2.6	Current balance	Q3 09	-108.03	-184.18
	Leading indicator	Nov. 09	1.0	6.8	Unemployment rate	Nov. 09	10.0	6.8
	Consumer price index	Nov. 09	0.1	1.8	Interest rate	Dec. 09	0.22	1.77
Euro area	Gross domestic product	Q3 09	0.4	-4.1	Current balance	Oct. 09	-6.83	-13.10
	Leading indicator	Nov. 09	1.1	10.9	Unemployment rate	Oct. 09	9.8	7.9
	Consumer price index	Nov. 09	0.1	0.5	Interest rate	Dec. 09	0.71	3.29
Non-members								
[1] Russian Federation	Gross domestic product	Q3 09	1.0	-9.2	Current balance	Q4 08	9.28	25.01
	Leading indicator	Nov. 09	1.0	3.4	Unemployment rate		..	..
	Consumer price index	Nov. 09	0.3	9.1	Interest rate	Oct. 09	9.50	17.17
[2] Brazil	Gross domestic product	Q3 09	1.3	-1.5	Current balance	Q1 09	-3.06	-8.38
	Leading indicator	Nov. 09	0.8	-1.3	Unemployment rate		..	..
	Consumer price index	Nov. 09	0.4	4.2	Interest rate		..	..
[2] China	Gross domestic product		..	..	Current balance		..	..
	Leading indicator	Nov. 09	0.2	7.6	Unemployment rate		..	..
	Consumer price index		..	..	Interest rate	Oct. 09	1.81	4.25
[2] India	Gross domestic product	Q3 09	3.1	6.8	Current balance	Q2 09	-5.81	-9.02
	Leading indicator	Nov. 09	0.0	4.3	Unemployment rate		..	..
	Consumer price index	Nov. 09	1.8	13.5	Interest rate		..	..
[2] Indonesia	Gross domestic product	Q3 09	1.6	4.2	Current balance	Q3 09	2.23	-0.50
	Leading indicator	Oct. 09	0.7	0.5	Unemployment rate		..	..
	Consumer price index	Dec. 09	0.3	2.8	Interest rate	Nov. 09	7.68	10.83
[2] South Africa	Gross domestic product	Q3 09	0.2	-2.5	Current balance	Q1 09	-3.88	-6.20
	Leading indicator	Nov. 09	0.9	2.8	Unemployment rate		..	..
	Consumer price index	Nov. 09	0.0	5.6	Interest rate	Dec. 09	7.07	10.87

Gross Domestic Product: Volume series; seasonally adjusted. **Leading Indicators:** A composite indicator based on other indicators of economic activity, 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 US$; seasonally adjusted. **Unemployment Rate:** % of civilian labour force, standardised unemployment rate; national definitions for Iceland, Mexico and Turkey; seasonally adjusted apart from Turkey. **Interest Rate:** Three months; *refers to Euro area.

..=not available

[1] Accession candidate to OECD

[2] Enhanced engagement programme

Source: Main Economic Indicators, October 2009

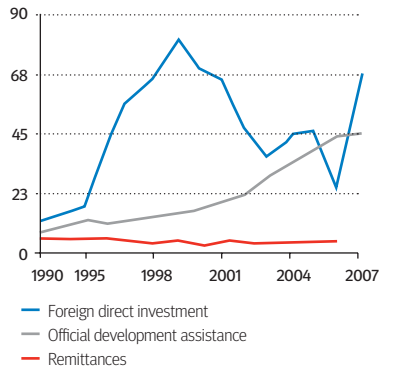
Send-home pay

Has the crisis affected remittances from migrants abroad? One survey has found that migrants from Latin America based in the US are still sending money home even if that means cutting expenses, taking second jobs, working more hours or, if they have lost their jobs, dipping into their savings.

However, while remittances tend to be much less volatile than other flows, even exports, the same survey shows that the value of those remittances to the region dropped 11% in 2009. This was largely due to huge job losses in some sectors of the US economy that traditionally attract immigrant labour, such as construction. Spain is undergoing a similar downturn in construction. Japan, which is also an important source of remittances to Brazil and Peru, has seen declining industrial production as export demand has slumped.

Rising remittances

Net capital flows to Latin America, constant prices, US$ billions



Source: OECD Development Centre calculations, based on IMF International Financial Statistics and Balance of Payments Statistics databases

Historically, remittances to Latin America are not only large relative to the size of local economies, they are also large relative to other capital inflows. They are comparable in size to foreign direct investment flows and greater than official development assistance, for instance. And total remittances have grown since 1990 (see graph). Remittances accounted for less than 0.1% of GDP in 1980; by 2007, that proportion had risen to 1.5%.

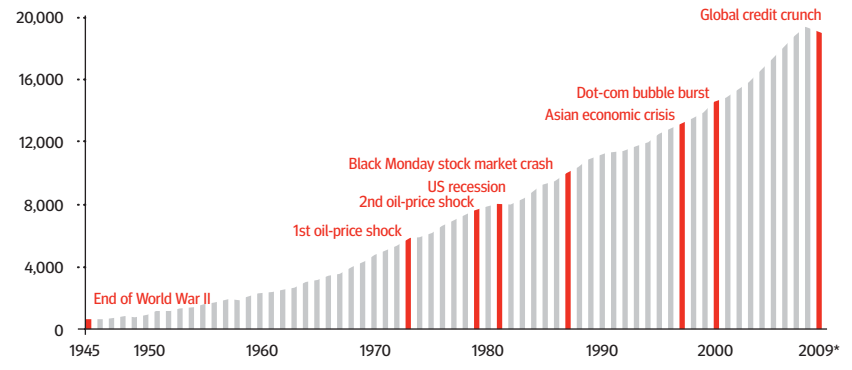
Latin American Economic Outlook 2010 is available at www.oecd.org/bookshop, ISBN 978-92-64-07521-4

Current trends

Global electricity demand declined in 2009 for the first time since the end of World War II according to OECD estimates. Electricity demand experienced a constant climb over the second half of the 20th century through the oil crises of the 1970s, the Black Monday crash of 1987, and on through the dot-com bubble bursting at the turn of the millennium as development countered all downward forces. The credit crunch of 2008 though, has resulted in a drop of as much as 1.6% based on OECD figures derived from the IMF's latest GDP growth forecast for 2009.

The drop-off in demand accelerated in the first quarter of 2009, with electricity consumption falling by 4.7% compared to the first quarter of 2008. OECD electricity demand fell by an estimated 2.7% in the second quarter. Demand also weakened in non-OECD regions. In China, for example, demand fell by a staggering 7.1% in the fourth quarter of 2008, by 4% in the first quarter of 2009 and by an estimated 0.6% in the second quarter.

Historical world electricity consumption



Note: *International Energy Agency estimate
Source: IEA databases and analysis

Electricity growth is expected to fall most dramatically in Russia due to slumping gas and oil earnings, followed by a decrease in usage across the OECD. This drop in demand is reducing the need for new capacity and driving down power-sector investment. In turn, needs are being fulfilled by lower capital options, which usually favor older technologies, such as natural gas and coal, instead of newer, costlier investment in greener energy from nuclear and renewable sources.

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