



Business and Industry Advisory Committee to the **OECD**

Comité Consultatif Economique et Industriel Auprès de l' **OCDE**

# **BIAC Statement to the OECD Council Meeting at Ministerial Level**

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**I. Trade, Global Sourcing and Structural Adjustment:  
*Policies to Promote Growth and Employment***

**II. Strengthening Growth in an Era of Demographic  
Change: *Facing the Challenges of Ageing Societies***

# I. Trade, Global Sourcing and Structural Adjustment: *Policies to Promote Growth and Employment*

## Executive Summary

1. New patterns of industrial production have major implications for business and society. Comparative advantages are shifting, new sources of competition are being created and the not so new phenomenon of “outsourcing” is raising concerns among policymakers and in the broader public perception.
2. These changes are a response to a multiplicity of factors, amongst them shifts in comparative advantages, new sources of competition, advances in technology and communications and changing consumer preferences.
3. The political debate on “outsourcing” must refrain from focusing on limiting inward and outward foreign investment. Governments must firmly reject protectionist policies that would restrict cost-effective investment decisions and competition, increase costs, and limit investors’ ability to allocate resources to their most productive uses. The opposite is required: the implementation of policies that encourage economic growth, spur trade and thus offer companies the opportunity to compete more efficiently and create employment.
4. BIAC believes that for OECD economies to respond to these challenges, the right policy mix must encompass a range of complementary measures:
  - **Promotion of worldwide free trade as key to stimulating economic growth;**
  - **Investment in education, training and re-training;**
  - **Policies that foster innovation, SMEs and entrepreneurship;**
  - **Broader structural reforms.**
5. BIAC welcomes the OECD’s new horizontal project on “Trade and Structural Adjustment” as a timely exercise and supports the involvement of every relevant directorate of the OECD in this project. The project is important for business because it aims at deepening understanding of the benefits of trade liberalisation and of the importance of appropriate adjustment policies. This should be the basis for policy recommendations to OECD member governments on how to best frame national trade adjustment policies. BIAC would like to see this project focus on:
  - **Enhancing the support for the multilateral trading system;**
  - **Fostering understanding of the benefits of trade liberalisation;**
  - **Deepening understanding of worldwide sourcing and the related data;**
  - **Addressing misconceptions about outsourcing;**
  - **Addressing the importance of outsourcing, exports and FDI for developing countries;**
  - **Providing information on national structural adjustment programs;**
  - **Emphasising the link between structural policies that facilitate adjustment taking into account the work of the OECD on the relationship between growth and structural reforms;**
  - **Best practices for regulatory frameworks to increase employment and labour mobility.**

## **Introduction**

The world trading system and countries' commitment to market liberalisation is under attack on many fronts. Governments have failed to make progress in the current WTO Doha Round of trade liberalisation, while wide-spread misconceptions regarding the benefits and perceived costs of global free trade and investment are leading policy makers to overreact and implement measures that are harmful to the world economy as a whole.

Companies engaged in worldwide sourcing and international investment increasingly find themselves in a defensive position against both public opinion and policy makers. Changing trade and business patterns, the consequences of increased foreign direct investment (FDI) and of "outsourcing" and "offshoring" have been stirring up public debates for decades. However, the issues at stake today are increasingly important and complex, a complexity which is not reflected in media coverage emphasizing alleged job losses attributed to worldwide sourcing by companies. The OECD has the skills and prestige to inject much needed data and facts into the debate as well as to produce the right policy recommendations for OECD governments.

In fact, the issue of how companies and sectors can adjust to restructuring pressures stemming from international trade liberalisation and new patterns of industrial production and services is not at all a new one for the OECD business community. What is new is that challenges that hitherto were predominately confined to the manufacturing sector now confront the service sector and higher-value activities on a global basis in a phenomenon that is commonly described as "outsourcing". In manufacturing industries, worldwide sourcing has already transformed companies from vertically integrated production structures to highly specialised production units linked by global supply chains.

Business has recognised the potential of this restructuring process to generate hardship - for individual employees, companies, even for an entire sector. Thus, we are very much interested in studies on how OECD governments have successfully enacted appropriate adjustment policies in the past and recommendations of how they may do so in the future in order to ease the transition process. This is the task of intelligent structural adjustment policies. But this is also the task of getting the right policy mix which must encompass a range of complementary measures, amongst them: Promotion of worldwide free trade as key to stimulating economic growth; investment in education, training and re-training; policies that foster innovation and broader structural reforms.

## **I. Trade and structural adjustment: Better understanding the “outsourcing debate”**

BIAC welcomes the OECD new horizontal project on “Trade and Structural Adjustment” as a timely exercise and supports the involvement of every relevant directorate of the OECD in this project. The project aims at deepening understanding of the benefits of trade liberalisation and of the importance of appropriate adjustment policies. It should be the basis for policy recommendations to OECD member governments on the best way to frame national trade adjustment policies.

New patterns of industrial production have major implications for business. Comparative advantages are shifting, new sources of competition are being created and the not so new phenomenon of “outsourcing” is raising concerns amongst policymakers and in the public at large. Nowadays, companies source products and product components from offshore producers around the globe because of advances in technology, transport, communication and as a way to meet competitive pressures through greater and more cost-effective efficiency.

It is therefore a challenging, timely and essential undertaking for the OECD to analyse country-specific case studies in eight sectors<sup>1</sup> and point out the domestic structural policies that would facilitate adjustment.

The starting point of this project should be that “outsourcing” is not a zero sum game and that many jobs are either kept or created during the process of worldwide sourcing as efficiency gains are transferred to consumers in terms of lower prices, or re-invested in new businesses. Thus, BIAC would like to see possible results of the OECD analysis focusing on:

- **Enhancing support for the multilateral trading system;**
- **Fostering understanding of the benefits of trade liberalisation;**
- **Deepening understanding of worldwide sourcing and the related data;**
- **Addressing misperceptions about outsourcing and the contribution of outsourcing to development;**
- **Providing information on national structural adjustment programs;**
- **Making the link between structural policies that facilitate adjustment taking into account the work of the OECD on the relationship between growth and structural reforms;**
- **Focusing on regulatory frameworks affecting entry and exit to labour markets.**

**BIAC believes that appropriate structural adjustment programs are an important policy tool to address the disruptive impacts of trade liberalisation and to maintain political support for open trade and commerce.**

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<sup>1</sup> Agriculture, fisheries, textiles and clothing, steel, shipbuilding, motor vehicles, health services and outsourced business process services.

## **II. Ever changing environment for business**

The old and simplified model of a multinational enterprise setting up a plant in a host country no longer corresponds to the reality of much of international investment as it exists today. Thanks to technological developments, continued rounds of trade liberalisation and a world wide opening up of sectors for investment, since the beginning of the 1990s companies have had a growing number of alternatives in international production.

FDI indeed dramatically soared before the recent downturn in 2001, and is now again increasing. Global FDI total outflows have been multiplied 17-fold since 1985 to 1.3 trillion US dollars in 2000<sup>2</sup>. As a result, the production and consumption of goods and services have been internationalised. Today, 60 000 parent companies have established more than 500 000 foreign affiliates worldwide. National firms, even quite small ones, have become multinational by increasingly localising their production facilities outside their home countries to benefit internationally from local competitive advantages. Companies transcend national borders by establishing a network of subsidiaries and linkages with local enterprises to relay outsourcing and offshore activities on a global scale.

This new pattern of international production has major implications for business, including the following:

- Changes in production processes and technologies;
- Increasing competition and new sources of competition (e.g., China);
- Constant pressures to reduce costs and improve productivity;
- Mismatches between job requirements and labour skills;
- Mounting labour compensation costs (including payroll taxes and benefits);
- Shorter product cycles and need for agility and flexibility, e.g. lower inventories;
- Importance of efficient international supply chains for reducing costs and reliable, fast delivery of components;
- Increased cost generated by enhanced supply chain security requirements;
- Proliferation of conflicting and too rigid e.g., not performance based, regulations.

## **III. Policy options for OECD governments**

The issue of how companies and sectors can adjust to restructuring pressures stemming from international trade liberalisation and new patterns of industrial production is not a new issue for the OECD's business community. What is new is that now the service sector is also confronted with the phenomenon described as "outsourcing" on a global scale. In manufacturing industries, outsourcing and international production of components transformed manufacturing from vertically integrated production structures to highly specialized production units decades ago.

For OECD economies the policy answers to these developments must encompass a whole range of supplementary measures:

- Promotion of worldwide free trade as key to stimulating economic growth;
- Investment in education, training and re-training;
- Fostering innovation, SMEs and entrepreneurship;
- Broader structural reforms.

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<sup>2</sup> OECD, "Foreign Direct Investment for Development", 2002, p 10.

## **A. Promotion of worldwide free trade as key to stimulating economic growth**

The world trading system and the open markets that it promotes are essential to sustainable economic growth, to supporting and diffusing innovation and technology, and to reducing poverty by creating wealth. Multilateral free trade policy has an important complementary role in helping countries absorb and capitalise on the growth and development potential of a rapidly changing global marketplace. The economic growth and improved living standards around the world we have seen over the past 50 years would not have been possible without the disciplines and achievements of the GATT/WTO system. Consequently, BIAC would like to express its strong concern to OECD governments about the continued stalemate of the current Doha Round.

The OECD business community remains strongly committed to the multilateral trading system with the WTO at its centre. Multilateral liberalisation of international trade is vital to lifting the developing world out of poverty and to creating business opportunities for both OECD and non-OECD companies.

- Re-starting the Doha Round, without overloading the agenda, is our top priority. OECD business organisations see a need to focus negotiations on: Non-agricultural tariff reductions and reduction of Non-tariff barriers, strengthened and expanded commitments on Services and finally Trade Facilitation.
- We also recognise that the WTO as a rules-based system needs to continuously improve "rules" and that such efforts are an important part of the Doha Agenda.
- For resolving the Cancun impasse, we believe it is crucial that negotiators overcome the deadlock on agriculture. This is a prerequisite for progress on other core issues. Market access for agricultural products needs to be improved and trade-distorting subsidies reduced, particularly in OECD countries. At the same time, OECD business and industry expects developing countries and emerging markets to help rebuild momentum for the Doha negotiations and to increase their own market access commitments for agricultural and industrial goods and services.

## **B. Investment in education, training and re-training**

Education plays an increasing and crucial role in the "innovation policy" of OECD countries. The quality of human capital is a key contributor to innovation and economic development and is becoming ever more important in the context of the knowledge society. As trade in services and information grows, tomorrow's economy will increasingly call for employees with new skills and competencies beyond those in the traditional economy. Therefore, an efficient education system, adapted to the ever changing needs of the labour market, and the improvement of skills and employability are both crucial to continued economic growth and increased employment.

Education, research and development, and the use of new technologies are key factors to promote employment, competition and economic growth. Links between education, innovation and technology need to be continually strengthened; in this context basic literacy, numeracy and scientific knowledge are fundamental.

The increasingly dynamic labour market brought on by globalisation has necessitated an important shift in thinking about goals of education. Rapidly evolving job profiles responding to market needs require employees to have an education that equips them with the ability to

respond and adapt to market changes and new technologies. This need become even greater as a result of changing demographics (see Part II below). Likewise, management of companies is increasingly horizontal, requiring teamwork to complete complex tasks, and emphasising entrepreneurship in exploring new business opportunities. OECD governments must:

- Reassess and improve existing public programs providing worker education, training. Adjustment assistance to ensure that they effectively addresses challenges stemming from trade liberalisation;
- Ensure that employees in the service sector must also have access to adjustment assistance programs;
- Ensure that education, lifelong learning and especially vocational education, are relevant to today's technology and service oriented economies.

### **C. Fostering innovation, SMEs and entrepreneurship**

OECD research has shown that while information and communication technology is a significant source and force multiplier for economic performance, an even more fundamental source of growth is innovation. The development of new products, processes and services drives improvements in productivity. It also facilitates the fulfilment of numerous societal needs, such as improved health and environmental protection. As has been elaborated by the OECD, innovation often involves organisational as well as technological change and requires sizeable complementary investments in worker training, manufacturing and marketing, in addition to investment in R&D. Governments need to foster investment and innovation through government funding and sponsoring, including offering tax incentives for R&D.

There is a continuous need for better understanding of how innovation impacts economic prospects and what other factors must be in place to generate a sustained, economy-wide improvement in productivity and output. In fact, innovation appears to be playing an increasingly important role in driving economic growth.

The following general conditions must be in place in order for innovative opportunities to spread quickly in the context of economic activity:

- A regulatory and legal environment that is strongly in favour of open market competition and business creation;
- Incentives to encourage skill acquisition and necessary changes in the organisation of the workforce;
- Continuation of strengthening standards world-wide for intellectual property rights protection;
- Closer relations between industry and academia to raise standards of excellence, ensure effective knowledge and technology transfer and achieve mutually beneficial personal exchanges and awareness;
- Generally, encouragement for SME and entrepreneurship development.

## **D. Broader structural reforms**

In fact, adjustment to trade-related impacts addresses only a fraction of the dislocations caused by competition and innovation in domestic markets. Therefore, any adjustment programs directed at trade impacts should be integrated with larger efforts to address on-going, non-trade related structural adjustment needs within national economies.

Longer-term adjustment responses will necessarily involve a broader range of policies, including macroeconomics, job creation and competitiveness initiatives, regulatory policies as well as labour market adjustment policies.

Accordingly, BIAC continues to support the OECD's conclusions concerning the reasons for divergence in growth and economic performances across OECD members. Results show that the causes can largely be attributed to different national policies. Although growth trend divergence in OECD countries has been caused by multiple factors, as a general rule, overly rigid policy settings are to blame for bad performance and reform options urgently need to be considered. BIAC urges continued OECD work on defining necessary reform efforts.

The prevalence of heightened economic risk, which featured high on BIAC's agenda at last year's consultation with OECD Ministers, has seemed to diminish as factors have shifted. However, we have clearly seen some economies remain more robust in resisting shocks than others. Again, structural flexibility and structural policy settings are fundamental determinants of the resilience of economies to shocks. Work in the OECD on this message is important for business in order to keep the pressure on OECD governments to undertake needed reforms.

Appropriate macro-economic policies and a performance-based regulatory environment that is favourable to entrepreneurship are necessary for boosting employment. The OECD has made an excellent contribution in this respect through its Growth Study as well as its Jobs Study and follow-up reports. BIAC also supports additional work on these subjects in the context of the new OECD horizontal Trade and Structural Adjustment project.

The business community is focused on dialogue with major stakeholders to generate necessary reforms for bringing about more jobs and economic growth. In this context, BIAC conducted a survey of its members examining what positive steps could be taken to improve employment rates in OECD countries. The following are a number of key concerns raised by business in OECD countries in their survey responses:

- The heavy burden of taxation and social security contributions, which constitute a barrier to employment, in particular with regard to unskilled or low-skilled workers.
- Over-regulation and lack of flexibility in the labour market. For example, overly rigid employment protection legislation is often a disincentive for companies to hire due to the difficulties they encounter in an economic downturn.
- Overly bureaucratic regulations for the hiring of temporary workers. In this context, practical instruments should be considered for temporary workers who wish to join companies' workforces when possible and when employers are satisfied with their performance. Greater flexibility in working patterns and work arrangements would be beneficial.
- Imbalances between available skills and market demands continue to be a pressing issue. Closer links between the education system and the labour market are necessary, and forward planning is essential.

- Low activity rates of certain parts of the population (for example: older workers, young workers, and women) must be tackled. Increasing employment rates among those groups will be crucial in view of the demographic changes we face.

Governments must take on the growth and employment challenges involved with new patterns of industrial production, including the not-new phenomenon of outsourcing. Apart from the need to apply worker-sensitive trade adjustment policies, BIAC continues to strongly believe in the necessity of structural reforms that will stimulate demand and activate supply in labour markets.

The need for structural reforms implies: fostering entrepreneurship, allowing for greater flexibility to manage human resources, activating the supply side of the labour market by addressing the needs of all groups and, stimulating investment in human capital formation and the promotion of life long learning. The OECD project on Trade and Structural Adjustment should also examine these areas of inflexibility that inhibit such adjustments.

## **Conclusion**

Business believes that governments should not let the outsourcing debate be dominated by those simply criticising the transfer of jobs overseas. The political debate must refrain from trying to set limits on inward and outward foreign investment. Governments must firmly reject protectionist policies that will restrict cost-effective investment decisions and competition, increase costs and limit investors' ability to allocate resources to their most productive uses. The opposite is required: the implementation of policies to encourage economic growth, spur trade and thus offer companies the opportunity to compete more efficiently and create employment.

While the cost to individuals who lose their jobs is obvious, the benefits of efficient and cost-effective sourcing – such as lower prices for goods and services and increased exports to emerging economies – are clearly there, however difficult they may be to estimate quantitatively. Much remains unknown about the role of outsourcing and offshoring in OECD economies and the impacts on employment and productivity. BIAC believes that the OECD can be very helpful in injecting much needed rationality into this debate. Whether by examining the benefits of foreign direct investment to the home country, or by analysing the scale of adjustment pressures stemming from improved productivity rather than worldwide sourcing: the potential role for the OECD in clarifying this debate is enormous, and BIAC encourages the organisation to undertake this analysis.

## **II. Strengthening Growth in an Era of Demographic Change: *Facing the Challenges of Ageing Societies***

### **I. Introduction**

Over the next decades, most OECD countries will experience a significant ageing of their populations. Falls in fertility rates and increasing life expectancy will raise significantly the number of elderly as well as the cost of age-related expenditures. At the same time, the acceleration of ageing populations will lead to a decrease in the labour force participation rates. This shift has led to increasing concerns about the viability of our social security systems and about declines in productivity and economic growth.

Reforms are needed in a number of areas to adjust to these developments. In order to secure sustainable economic growth and at the same time tackle the other problems associated with current demographic challenges, it is crucial to increase the employment rates of older workers.

In BIAC's view, the following are among the key measures that address meeting the challenges of ageing societies, a major theme of this years' OECD Ministerial discussions.

### **II. Creating a framework for growth**

To increase employment rates is a major challenge for many OECD countries. A sound policy framework strengthening the competitiveness of companies is an essential prerequisite for the private sector to make its full contribution to creating new jobs, and thereby to funding social welfare networks in the future. Economic growth and structural change that are accompanied by improvements in public health and reforms in social welfare, are key factors for sustainable employment. Particular attention should also be paid to encouraging self-employment and to improving conditions for the creation and growth of micro-businesses and SMEs, which play a crucial role in job creation.

Job growth can only be achieved if Member states implement the necessary structural reforms of their economies and facilitate policies which are conducive to greater flexibility, competitiveness and job creation. Some steps have already been taken. However, these measures frequently do not go far enough in addressing the serious structural problems that exist in most of our countries.

Companies require increasing flexibility in the labour markets in order to respond to market shifts, customer needs and competitive pressures. The overall burden of taxation on both citizens and companies is high and serves as a structural disincentive to growth in general. A more efficient and competitive environment must be created, in which labour markets are sufficiently flexible so that companies can match the right skills, employees and the organisation of work in response to changing circumstances. The expansion of the knowledge society, the diffusion of new technologies, ageing populations and the increased cross-border movement of people and ideas will define the key challenges for education policies, work organisation and labour markets for the years to come.

### III. The implications of ageing societies

In most OECD Member countries, the general tendency is for people to lead longer and healthier lives. This positive development, however, has a number of economic consequences. For example, under existing structures most OECD countries are experiencing deficits in their social security budgets, including health, that are expected to increase under pressure from economic, demographic and social changes. For social security institutions, in particular with regard to retirement benefits and health insurance, structural changes are needed in many countries in order to avoid a collapse of these systems as a whole.

Ageing populations, declining birth rates, longer schooling and earlier retirement are reducing the proportion of the population that will work and pay taxes to support the growing number of people receiving pensions, payments (i.e. unemployment, student support, disability), and health care. In view of these developments, early retirement can only exacerbate the problems resulting from ageing societies. Instead, a climate conducive to “active ageing” should be encouraged, which means providing support for people to lead active lives as they grow older. A frank and open dialogue on this issue at national and international levels is essential in developing appropriate strategies for dealing with the problem of ageing populations, including the reform of pension systems and the promotion of active ageing.

### IV. Expanding employment for older workers

A first consideration in the effort to secure employment for older workers is that jobs must be available. The promotion of older workers should focus first on considering how the total volume of employment opportunities can be increased. In order to expand employment opportunities, it is necessary to create a business environment that helps the private sector to grow and create sustainable jobs. The overall labour market must be functioning smoothly and real incentives to work must be given. This requires government policies that encourage job creation through entrepreneurial activity and reform or eliminate regulations that needlessly impede starting or expanding an enterprise.

Apart from underlining the importance of creating an enabling framework for general improvements in the labour market, the following measures with respect to older workers should be considered including:

- **Increasing the effective age of retirement;**
- **Diversification of working times and work organisation;**
- **Increasing emphasis on lifelong learning;**
- **Analysing the effects of employment protection measures;**
- **Encouraging more wage flexibility;**
- **Promoting effective job placement.**

- ***Increasing the effective age of retirement***

The early withdrawal of older people from the labour market and the redistribution of labour from old to young workers can have a negative effect on the labour market, and in particular social security systems. In order to secure sustainable economic growth and to ensure the viability and sustainability of our social security systems, the employment rate of older workers needs to be increased. Policies to increase the average retirement age need to go hand in hand with policies that make it easier for enterprises to employ older workers.

- ***Diversification of working times and work organisation***

The diversification of types of employment and the introduction of flexible work-sharing/work-time arrangements can be an important step towards improving the employment prospects of older workers. Different types of working patterns should be considered, such as working from home using ICT. Age-related part-time work should be used as a flexible instrument to respond to the needs of certain older workers. Flexible work schedules and work locations also help older people to find a smoother transition to retirement.

- ***Increasing emphasis on lifelong learning***

Maintaining the employability of older workers is crucial for increasing their participation in the job market. Lifelong learning is generally recognised as an important issue, and should be the shared responsibility of government, employers and employees. Training measures for older people are of crucial importance, but they should be tailored on a case-by-case basis, and priority should be given to well-targeted short-term measures.

- ***Analysing the effects of employment protection measures***

In many countries, policies often considerably increase the effective costs of laying off older workers. Likewise, employment protection measures that are too strict may lead to lower hiring rates especially of older workers and can thus make it more difficult for older people to find a job. What were been originally conceived as worker protection mechanisms have increasingly developed into a hurdle to employment of older people. In order to improve the employment opportunities of older workers on a long-term basis, it is crucial that increased flexibility be introduced.

- ***Encouraging more wage flexibility***

It is necessary to reform the conventional seniority-based wage system towards a more skill- and performance-based system taking into account employees' intentions and companies' conditions. One area where further work should be carried out is on the effects of seniority wages on employment opportunities of older workers. Pay rises are often too closely linked with the duration of the number of years worked. This places growing pressure on business not to hire older workers or to encourage older workers towards an early exit into pensions. Therefore, in order to remove employment barriers for older workers, remuneration systems need to be adjusted. Age-related pay increases should be gradually wound down.

- ***Promoting effective job placement***

A labour market policy which encourages people to take jobs must also build bridges into new work activity for older workers. For older workers, as for other groups, targeted placement is the most effective instrument for reintegration in the labour market. It is crucial to focus on active and rapid job search assistance, in addition to improving the quality of the general job brokerage systems. Matching between companies' needs and job seekers' skills must be improved, which can be facilitated by closer liaison of Public Employment Services (PES) with companies and encouraging private employment services.

## **V. Conclusion**

Economic growth continues to be the most important basis for employment creation including for increasing the employment rate of older people. In this context, governments should focus on having more efficiency and flexibility in the overall labour market.

With regard to older workers, governments must continue to focus on policy measures that encourage older workers to remain longer in the workforce. In view of the current demographic shifts, the skills and knowledge of older workers are an essential element for a competitive labour market. Encouraging “active ageing” is a positive step in addressing the issues created by ageing societies including addressing current pressures on pension schemes.

BIAC highlights the importance of the OECD Jobs Strategy with addresses key policy issues focused on employment creation including aging and employing older workers, and looks forward to contributing to the reassessment of the Jobs Strategy recommendations and related analysis.