



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

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

*REV. 1*

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

**Paris, 15 May 2002**

### **OECD AND THE SUSTAINABILITY OF THE MARKET ECONOMY**

**Jobs Strategy, Regulatory Reform, Growth, Sustainable Development...**

#### **What Next?**

*(Revised on 7 May 2002)*

*It is recommended to print this statement on both sides of paper, in such a way as to have the text and the table or the figure of the same plate on facing pages.*



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## MAIN MESSAGES

BIAC is pleased to submit this statement to the OECD Council meeting at Ministerial level on behalf of the business communities of the member countries. This statement presents a set of assessments and broad recommendations which should be seen as complementary to the Organisation's own report on its work since the last Ministerial meeting. In other words, in this statement BIAC does not seek to register all its views on all aspects of the OECD work. This statement instead dwells on those areas where the business community believes an additional emphasis is needed at the OECD. BIAC submitted a Discussion Paper on *Innovation and Global Sustainable Growth*<sup>1</sup> to the 2001 OECD Council meeting at ministerial level, containing a more detailed policy mosaic necessary to sustain growth within an open international trading system. Most of its recommendations remain valid.

Following a section on the current macroeconomic situation (Plate 1), the statement is organised around a structure which asserts that "sustainability" should be assessed along a number of dimensions including the societal, the economic (which includes the institutions of the market economy), and the environmental. We have chosen to follow this framework in order to engage in a discussion within a structure which has already been used by the OECD in their study on Sustainable Development. Indeed, more work needs to be done in order to obtain a clear understanding of sustainability from societal and economic perspectives.

But, in the end, from a policy point of view, we need to explore the interactions between the various so-called dimensions of sustainability, which requires a focus on the trade-offs. And, trade-offs are precisely the stuff of economics... and political reality.

As a statement from a community of practitioners of the economy to makers of policy meeting under the roof of an Organisation which is designed to conduct fact-based analysis, this statement could neither be pure research nor a pure political declaration. The illustrative charts and quantitative information used to back the assessments made are not intended to provide conclusive evidence on the points and recommendations made. They are instead intended to suggest avenues for further analytical work and policy development by the OECD. The main messages of this statement are as follows.

Notwithstanding the downside risks which at the moment are real for all OECD regions, the global economy seems on course for a recovery, more swiftly in regions with more flexible labour markets and better regulatory environments, which should soon bring us back to a discussion at the OECD on differentials on long-term growth and development. (Plate 1.)

There remain significant differentials among the OECD countries in terms of their ability to use labour markets to generate economic opportunities for poor, and in terms of investing broadly in human capital needed in a knowledge economy, which underlines the need to update the *OECD Jobs Strategy* and implement its recommendations (Plate 2.)

The disparities among OECD countries in terms of the quality of the business environment are large, and these are likely to matter more in the future as more business will be conducted with a global comparative logic, which means that a continuous process of multilateral structural surveillance is the most crucial service the OECD can offer to its member countries (Plate 3.)

Despite rhetoric, sustainability continues to be discussed mostly in terms of environmental policy, while human, societal and economic dimensions of sustainability, and indeed the technological progress itself, are mostly taken for granted. OECD is well placed both to clarify the trade-offs and make the discussion on sustainability less emotional (Plate 4.)

More OECD effort needs to be devoted to clarifying the role of openness to international trade and investment in raising the growth and development potential of both advanced economies as well as developing countries, and in projecting that message to inform the world-wide debate on "globalisation" (Plates 5. and 6.)

The analysis contained in recent publications such as *Open Markets Matter* and *GATS: The Case for Open Services*<sup>2</sup> goes a long way towards reminding us of the link between openness to trade, multilateralism and development. We believe that more effort of similar analytical nature needs to be carried out on the international investment side as well. In addition, we believe that there is a need for a renewed commitment at the political level to remake the OECD a beacon for open markets.

### ***What next?***

Jobs Strategy, Regulatory Reform, Growth Study, Sustainable Development...Over the last decade, the OECD's flagship policy studies have helped the makers and practitioners of public policy understand and articulate the case for economic and institutional reform needed to preserve the market economy, the basis of our shared prosperity. And some reform did in fact take place. BIAC sees the OECD's most important contributions in the years ahead in the form of similar types of cross-cutting, policy-focused analyses which remain founded in scientific analysis.

Given the heightened level of confusion and cynicism presently surrounding international economic relations, a study of similar magnitude on "Openness" appears necessary. Parts of this statement indicate specific avenues which could be pursued as part of such an Organisation-wide study.

Beyond suggested analysis, with this statement BIAC calls upon the ministers to exercise political leadership to enable the OECD to remain a group of 30 nations which are *jointly* committed to preserving and advancing the market economy on a global scale. Notwithstanding any disagreements among them on specific issues, it is crucial that OECD member countries maintain and practice the view of a global market economy as a positive sum game, in order to expect that the same view take a firm hold in the rest of the world.

All countries are equal legally and in practice (as any negotiator at the WTO knows.) We still expect the major economies to exercise a leadership on global issues, for example in the form a G8. The OECD could also be seen as a complementary layer in the broadening of a consensus among the advanced democratic nations towards generating the common and compatible policies required to address common problems. There is an opportunity for the OECD to employ its considerable analytical and consensus-building capability as a closely-linked platform for the G8 in that institution's role of global leadership. Across the policy spectrum, the Organisation can provide data integrity, vertical and horizontal analysis and structured debate to better prepare end follow-up G8 meetings.

## Plate 1. The Lessons of a Brief Slowdown?

Global economic activity is well below potential but an expansion is gaining momentum, after what is turning out to be a brief and shallow downturn by historical standards. An aggressive monetary easing and fiscal stimulus in the US brought deceleration to an end in the 4th quarter of 2001. Both the scope and room for monetary and fiscal policy remains more limited in the Eurozone, and virtually non-existent in Japan. BIAC is cognisant of the serious downward risks which threaten the pickup of an investment-driven recovery. Nevertheless, the present assessment is based on consensus forecasts.

An initial conclusion is that, in addition to the significant differentials that have emerged among major OECD economies with respect to their long-term performance in growth and employment, as identified by the *OECD Growth Study*, differentials may begin to become accentuated in their ability to respond to cyclical fluctuations. This entails the possibility of lasting differentials in the economic performance of major OECD economies, with long-term consequences on the cohesion of the OECD as a group of structurally similar economies with like-minded governments. Several tendencies depicted on Plates 1A and B<sup>3</sup> are worth an emphasis:

- the GDP rebound in the US promises to be swift, just as the downturn was;
- the Eurozone appears to be heading towards a longer slowdown and a larger cumulative output gap; but perhaps even more importantly,
- at the peak of this cycle US unemployment was substantially lower than at the previous peak;
- Continental Europe's "high unemployment" economies face a reversal of their employment performance, which had been improving for some time. They remain "stuck" at higher structural unemployment and lower employment rates. Movements in the Continental European unemployment rates are more subdued in either direction, and these do not seem able to sustain a steady rate of reduction in unemployment for periods of 7 or 8 years, as the UK and the US were able to.
- Technical debates on the exact value and implications of the NAIRU notwithstanding, a significantly lower "speed limit" is evident for the larger Eurozone economies, and no major progress seems to have been made in terms of raising it.

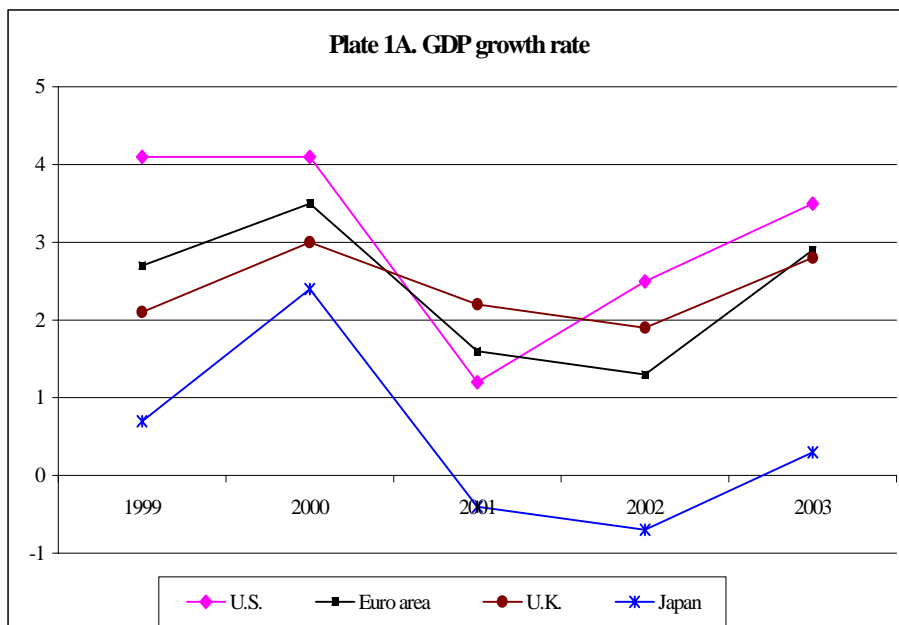
While, among other things, higher population and labour force growth may partly explain US's higher sustainable GDP growth path, these alone would not explain the velocity of its adjustment. ***The present rebound is in progress, more swiftly where labour markets and wages have made their adjustment to slower activity.*** Where the institutional rigidities of the old economic framework remain strong (e.g., Germany, Italy and Japan among the larger economies), the downward cycle will be longer and more painful, also slowing down the recovery of other inter-dependent economies in their respective regions.

### ***Recommendations***

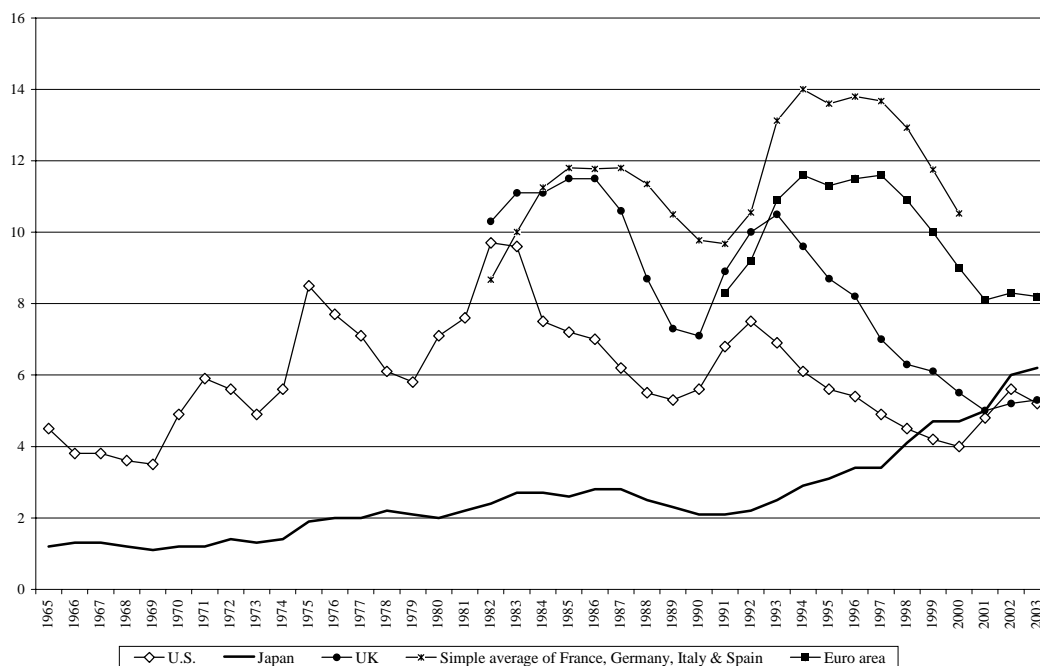
OECD should deepen its analytical work on the implications of a knowledge-based economy on the business cycle and short term fluctuations. Going further than a consideration of ICTs or "new economy", such work should explore the linkage between the economies' "structural dynamism" (labour market flexibility, regulatory quality, etc.) and the business cycle. An important policy question for the EPC<sup>4</sup> and

OECD in general is the implications of a business cycle which may have changed in some OECD countries but not in others.

Despite the short-term preoccupation of the current conjuncture (slowdown, security risks), there remains a huge unfinished business in terms of understanding and implementing the reforms needed for long-term sustainable growth. OECD has well developed, albeit gradual and lengthy, mechanisms for monitoring the implementation of structural reform on a country-by-country basis [EDRC, Regulatory Reform project]. This work could be augmented by cross-country benchmarking on structural dynamism [EPC, CIBE].



**Plate 1B. Standardised Unemployment Rate (percent of labour force)  
Estimates (1965-2001) and projections (non-standardised, 2002-2003)**



## **Plate 2. Sustainable Growth: "The Societal Dimension"**

In order to be socially and politically sustainable, economic growth must mean a sustained growth of income and opportunities for society broadly, and especially for lower income individuals<sup>5</sup>. This is not a statement about "equity" or "distribution" of income. The market economy and the characteristics of human capital accumulation process usually imply that individuals' earning process vary considerably across their life span and between one another. However, a significant population of individuals who are permanently stuck in poverty is antithetical to the notion of sustainability in a democratic society, and can undermine support for the market economy.

Growth of earnings at low income levels in turn depends on two things: growth of market income and social transfers. Many countries have been increasingly relying on redistribution of income. But the sustainability of this trend is questionable. In an economy that is constantly subject to technological and structural change, where productivity is continually pushed up by new methods, social policy ultimately depends on the ability to raise the productivity of the population at lower income levels.

Each social transfer policy can be evaluated on its own merits. However, there is need to restore the understanding that, especially at lower income levels, the ability to work is ultimately the main determinant of sustainable income growth. Available information suggests that the distribution of market income has recently widened in OECD countries.<sup>6</sup> If continued, this trend would make social policies based on redistribution more difficult to sustain and less effective. However, there are significant differentials in the degree to which the income share of the lowest 30 percent of the population has fallen. There is some evidence shown on Plate 2A that the loss of income share among the poorest is greater where *employment* rates are falling. Considering that the data here is on *changes* in shares of income, where the average is growing, it is likely that in countries at the top of the chart the actual real income *level* of low-income groups has in fact modestly risen.

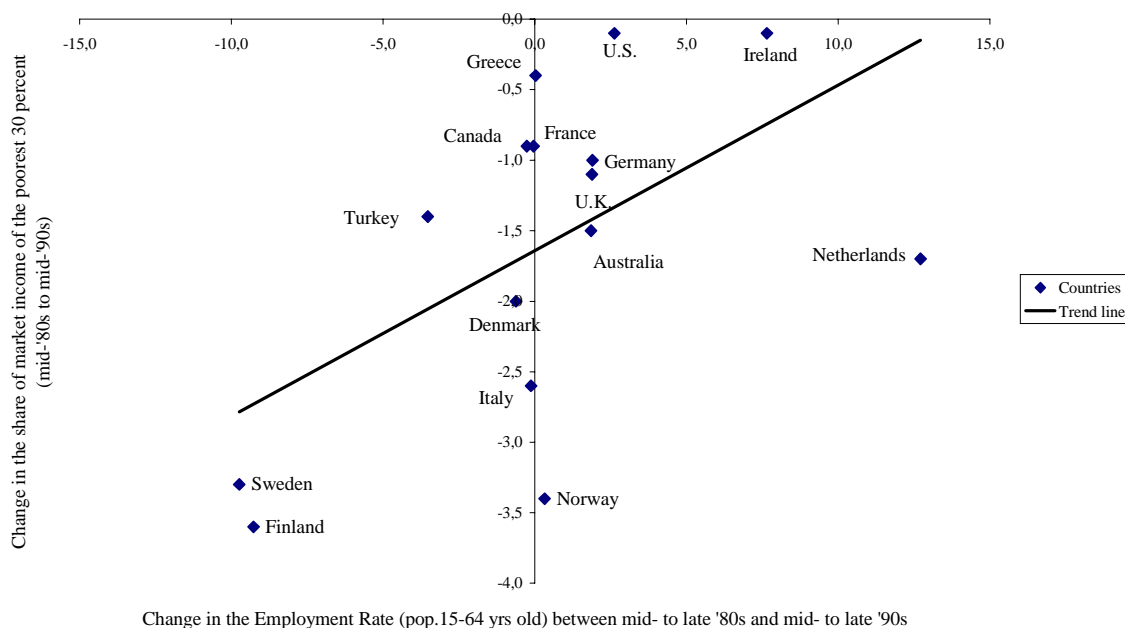
Another crucial aspect of human development is human capital development, which has clear implications for the sustainability of growth in an increasingly knowledge-based economy. As OECD countries have broadly converged in terms of basic educational attainment, policy attention needs to shift to more sophisticated indicators. The results of *PISA 2000* raise important questions with respect to fairly divergent results in the quality of education.<sup>7</sup> There is also a general awareness that at the higher education end, coverage and performance of both education and its relationship to research vary strongly among OECD countries, with impacts on the performance of the economy.<sup>8</sup> In Plate 2B we take a look at just one measure of the quality of the learning environment to illustrate how the otherwise structurally similar OECD countries differ in one of the crucial components of readiness in ICT education.

### ***Recommendations***

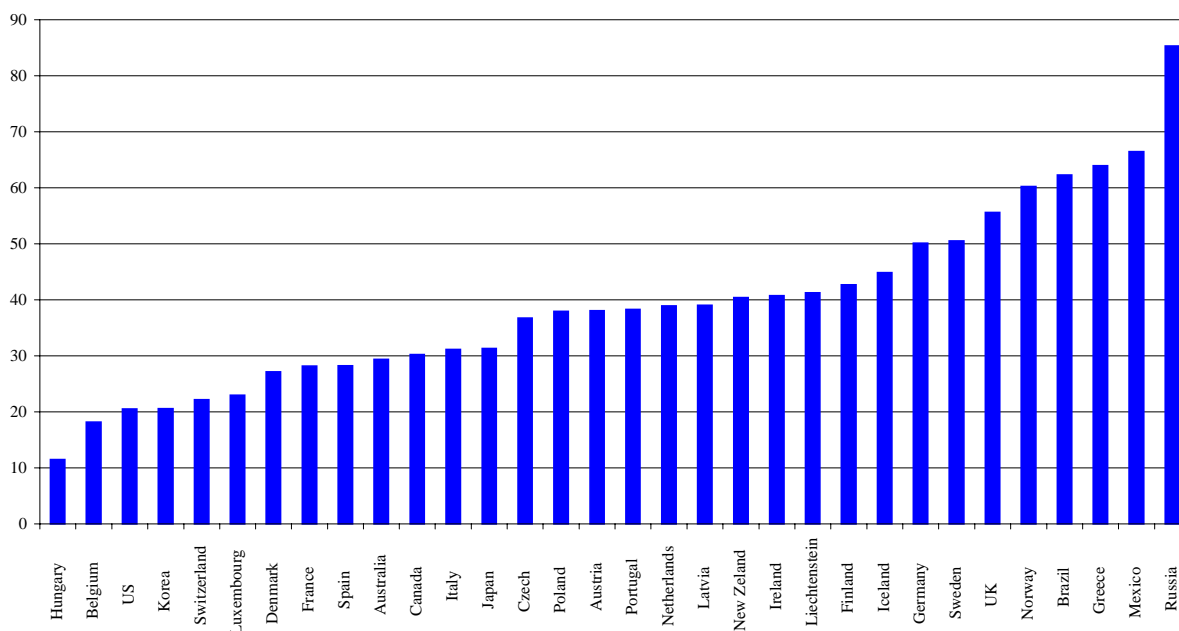
***Employability and human capital development should be viewed as being among the principal indicators of sustainable prosperity.*** Measures of labour market performance and employability of low-skilled population should be included as part of sustainability indicators. Beyond the work on sustainability as such, the OECD needs to conduct an update of the *Jobs Strategy*. Specifically, the OECD could provide an update on the link between labour market performance and the ability of lower income groups to raise their income levels. Much of the available analytical policy tool kit on poverty issues focuses on relative *shares* of income. OECD could develop a better understanding of how *levels* of income evolve at the lower levels, what these mean in relation to human needs and ability of individuals to operate in a market economy [which is increasingly knowledge based], as well as help identify the extent of true poverty traps and the policies needed to address them.

More effort is warranted at the OECD to articulate human capital development for economic and societal sustainability in a knowledge-based economy. OECD should also emphasise the growing importance in a knowledge economy of modernising higher education and the need for closer co-ordination with social partners concerning vocational training.

**Plate 2A. Change in Employment Rates and Poverty**



**Plate 2B. Percentages of students enrolled in schools where principals report that learning is hindered to some extent or a lot by the deficiency of computers (PISA 2000 results)**



### **Plate 3. Sustainable Growth: "The Economic and Institutional Dimension"**

The flurry of research activity associated with the OECD Growth Study and similar analysis elsewhere generated sufficient evidence for the observation that economic performance diverged among OECD countries during the 1990s. The recent economic slowdown is not a sufficient reason to forget this important message.

There are obviously a large number of factors which jointly determine outcomes in long-term economic growth performance, with strong interactions between them. While OECD's focus on the impact of ICTs, innovation and multi-factor productivity was warranted as these were less well understood or articulated in 1999, the necessary complementary analysis on some of the other factors was not pursued with determination. Despite recurrent request and encouragement from BIAC, there was never a systematic look at the impact of competition in labour and product markets and the helpfulness of the regulatory environment on growth performance.

In this context we take a closer look at just one aspect of the business environment, which is summarised as "regulatory quality" to suggest an avenue for further work by the OECD. Plate 3 maps a measure of relative change in growth performance against a measure of overall quality of the regulatory environment. The first dimension is adapted from the *OECD Science, Technology and Industry Scoreboard 2001*. The second dimension is based on a composite indicator developed by Kaufmann, Kraay and Zoido-Lobaton at the World Bank integrating a wide range of cross-country measures in regulation.<sup>9</sup> Plate 3A classifies OECD countries with respect to changes in economic performance from the 1980s to 1990s. Cluster I represents countries which were already high-income (World Bank definition) in the 1980s and kept up with the growth rate of the US in the 1990s. In cluster II are high-income which lost ground to the US. A similar categorisation (clusters III vs. IV) is applied to the middle-income countries. Plate 3B provides an additional comparative snapshot on the regulatory quality variable only.

Quantitative benchmarking of a complex institutional variable (regulatory quality) is bound to have strong limitations. These notwithstanding, the major OECD economies with higher regulatory burdens (e.g., Japan, Germany, France, Italy) are clearly those with a worsening in growth performance. Besides, in an environment where capital is increasingly globalised, countries dependence on "regulatory competition" may be growing, which would make this sort of analysis increasingly relevant.

#### ***Recommendation***

In general, BIAC believes that the OECD Economic Policy Committee needs to take a more determined stand vis-à-vis the current complacency with respect to the regulatory and tax burdens which remain high and rising in many OECD economies. In its traditional style, the EPC could contribute to a reform agenda by elucidating analytical evidence on the relationship between the regulatory business climate and economic performance.

OECD work on Regulatory Reform has already provided a tremendous amount of additional insights on the institutional environments of the countries reviewed and has contributed to those countries' approaching structural reform within a coherent programme. It is now time to build upon the knowledge and understanding developed in this area with cross-country analysis and a robust multilateral surveillance process through EPC, PUMA and CIBE.

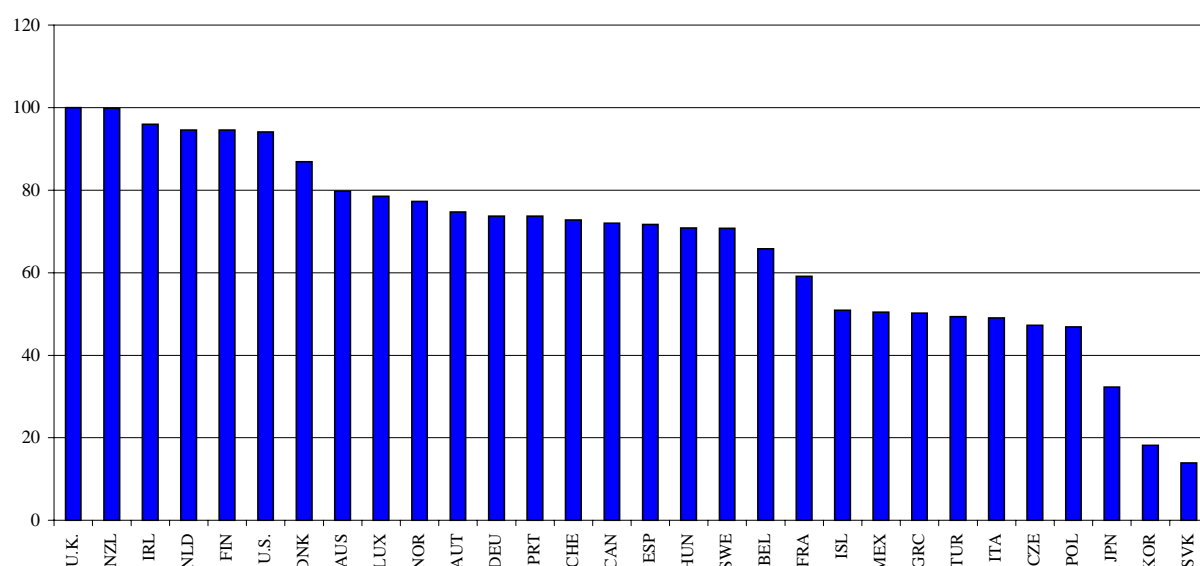
From a policy making point of view, regulatory burden and quality clearly cannot be reduced to a single-value indicator. BIAC invites the OECD to use cross-country analysis of regulatory conditions and a general assessment of the business climate in relation to economic performance.

**Plate 3A. GDP per capita (pc) growth 1989-1999 vs. Regulatory Quality in 1998**

(See notes at the end of the paper. Countries ranked (in Column 2) by growth performance with respect to the US, which is taken to have a GDP per capita equal to 100. "GDP pc catch up" measures the extent to which the country approached the US level (100) or fell behind during 1989-1999.)

Cluster II High income in the 1980s falling behind in the 1990s			Cluster I High income in the 1980s maintaining or improving their relative position in the 1990s		
	<i>Column 1</i>	<i>Column 2</i>		<i>Column 1</i>	<i>Column 2</i>
	<i>Reg. Quality</i>	<i>GDP pc catch up</i>		<i>Reg. Quality</i>	<i>GDP pc catch up</i>
New Zealand	100	-4.3	Norway (2)	77	5.2
Finland (1)	95	-4.7	Australia	80	3.6
Canada	72	-5.1	United States	94	0.0
Italy	49	-5.8	Netherlands	95	-0.1
France	59	-5.9	Denmark	87	-2.2
Sweden	71	-6.3	United Kingdom	100	-2.2
Germany	74	-6.3	Austria	75	-3.1
Japan	32	-7.8	Belgium	66	-3.3
Switzerland	73	-18.3			
Cluster IV Middle income in the 1980s falling behind in the 1990s			Cluster III Middle income in the 1980s continued catch up in the 1990s		
Turkey	49	-1.3	Ireland (4)	96	21.9
Greece	50	-1.9	Korea (5)	18	9.9
Hungary (3)	71	-2.1	Poland (3)	47	3.1
Mexico	50	-2.3	Portugal (6)	74	1.4
Czech Rp. (3)	47	-9.6	Spain (6)	72	0.5

**Plate 3B. A Composite Indicator for Regulatory Quality (Best country in 1998 = 100)**



#### **Plate 4. Environmental Sustainability**

The weakest link in the current discussions on environmental sustainability is the implicit assumption that technology will remain unchanged. And yet, we know from experience that technological innovation has been at the forefront of better environmental performance. Upgrading technology is a prerequisite for more effective use of resources and thus improving environmental performance, which becomes all the more important in view of a rapidly growing world population. In most cases, newer technologies and processes are both more efficient and less polluting than the technology they replace, allowing increased production using less material and causing less pollution. At the same time, environmental performance often presents business opportunities that enhance firm-level efficiency.

A competitive firm must have as robust a programme of cost reduction as it does in the pursuit of market share. Strategies to improve performance often also reduce negative environmental impacts. The first point of departure is to search for ways to reduce the use of inputs or materials and natural resources. Another focus is on the reduction of energy use. Lower costs, driven by competition, bring prices down and can in many cases improve environmental performance. More efficient production processes and products through innovation and a reduction in resource use and pollution can be mutually reinforcing objectives.

The market depends on a stable and supportive framework of public policy. Business benefits from regulation that is predictable and consistent, but not overly prescriptive. It is critical that the regulatory framework encourages innovation and fosters beneficial technological change. Given the economic, environmental and social importance of innovation, regulatory programmes need to fully take into account the effects of regulations on the development of new technologies. This can involve the revision of a single regulation, a regulatory regime, or the improvement of processes for managing reform. Regulatory reform to increase competition and encourage new market entrants is key to innovation. Policies need to be flexible and incentive-based and be designed to stimulate dynamic efficiency.

Regulatory programmes that take advantage of market forces can achieve impressive environmental results with lower transaction costs and fewer prescriptive requirements than traditional approaches. These tools – which rely on marketplace incentives rather than direct, command-and-control requirements to achieve environmental performance – need to be extended to a wider range of pollution control and prevention programmes. Innovations in product design, pollution prevention and resource management will work best in a regulatory system that builds on business's proven success in meeting requirements through investments in science, technology and process innovation. Fiscal policies need to provide incentives, e.g. lower statutory rates, R&D credits, for firms to invest and innovate, thereby improving environmental performance. Voluntary actions represent a promising approach with respect to many environmental problems.

Drawing on many recent innovations in environmental stewardship that have emerged from government and the private sector, public policies should foster a culture of performance-based management. This culture would focus on defining, measuring and rewarding environmental results and reorienting core regulatory functions so they are driven primarily by performance goals. Policies need to set clear, transparent goals that establish desired environmental outcomes and give business greater flexibility in determining how to achieve these outcomes. Regulatory renewal and a performance focus by industry to effectively track and communicate progress should also be encouraged.

The development and application of environmentally friendly technologies and know-how are already making a significant contribution to reducing the environmental impact of economic activities. The spread of innovative approaches to non-OECD countries will be crucial for environmental improvements. The main vehicle for this form of co-operation between industrial and developing countries has been and will

continue to be the private sector, through its day-to-day business activities of technology development, foreign direct investment and technology sales and dissemination.

The development impact of foreign direct investment goes beyond its monetary value and includes positive side-effects, such as the transfer of environmentally-friendly technology and know-how and the spread of efficient management practices. This is due to the managerial links between parent and subsidiary and the advantages of employing comparable environmental procedures throughout a multinational firm's operations. Trade and investment liberalisation is therefore essential to speed the transfer and diffusion of clean technologies. Governments should set enabling legal, fiscal, economic and social framework conditions for private investment and technology co-operation to take place.

### *Recommendations*

The OECD should put more emphasis on encouraging innovation to address environmental challenges. The Organisation should encourage governments to offer a policy framework that encourages innovation and beneficial technological change working with, not against, the grain of the market. OECD could also analyse how future technological improvement can be factored in environmental forecasting and indeed how its direction and speed can be affected by policy.

The OECD should examine and improve policies for encouraging the spread of innovation and know-how to developing countries.

The OECD should assess the economic and environmental effectiveness of policy instruments to address environmental challenges.

It would be of interest to develop indicators on public awareness of environmental challenges and support for environmental policy, including a willingness to pay for it.

## Plate 5. Dimensions of "Openness"

Openness of an economy to international exchange is the most reliable mechanism for bringing competition into sectors that have hitherto been sheltered from it. As barriers to merchandise trade have been progressively reduced in OECD countries in the last 50 years, most of the productivity- and growth-enhancing impact of future trade liberalisation is to be expected in the service sectors. Looking first at **trade**, a rapid glance on Plate 5<sup>10</sup> reveals that the service sectors of OECD member countries are not only fairly closed to international trade but also the extent to which they are so varies considerably. Column D depicts import penetration rate in services as a ratio of that in goods, which reaches a maximum of 43 percent in the case of Ireland. The larger economies are naturally less reliant on international trade. But the "openness" of service sectors relative to goods varies even more strongly among the smaller OECD economies.

Internationalisation can operate through related but distinct channels, including trade in goods and services vs. direct investment (capital) vs. production by foreign-controlled enterprises. Openness in these dimensions appears to have some relation to the divergence of economic performance observed in recent decades (see Plates 2 and 3). Sizeable **FDI inflows** and a significant foreign presence in an economy can be interpreted as an indicator of the confidence placed in that economy's business environment by the global business community. Among the larger economies, Germany, Italy and Japan are characterised by a combination of low FDI inflow and low shares of multinationals in domestic production and employment.

OECD (STI/EAS) database on Measuring Globalisation provides a wealth of data on the strong role played by **foreign-controlled affiliates** and how this varies in the OECD area. This meticulously compiled data base allows only some tentative conclusions. Unlike in trade as such, there is no clear-cut inverse relationship between size of the economy and internationalisation along this dimension of openness. In addition, the activity of foreign-controlled enterprises is nearly as large as foreign trade in many cases (larger for the US)<sup>11</sup>. This tendency is even greater in services than in manufacturing, which suggests that, to some extent, "globalisation" in services has been motivated so far by a desire to seek a place within otherwise sheltered national markets. In other words, unlike much of manufacturing, the global market in services remains terribly fragmented (especially in telecommunications and ICT services). There is no obvious justification for this state of affairs.

### *Recommendations*

BIAC strongly encourages further OECD work to support continued progress in WTO negotiations on market access for services, agriculture and industrial goods, including studies of linkages between trade and investment, transparency in government procurement, and trade facilitation. Engagement by all parties in the rules-based system is crucial. OECD should also continue to provide current analyses of relationships between trade policy and other areas including competition, regulatory quality and development.<sup>12</sup>

The excellent work on *Measuring Globalisation* should be disseminated and utilised assertively in order to bring a stronger element of factual reality check to ongoing debates on "globalisation". The Committee on Industry and Business Environment (CIBE) is well placed to demonstrate the link between openness and economic performance. CIBE, the Trade Committee and the Committee on Investment and Multinational Enterprises (CIME) should co-operate to restore the Organisation's ability to articulate the case for open markets. The existing database on foreign affiliates should be expanded to ensure a better coverage of countries and variables.

Plate 5. Dimensions of Openness

1998, unless otherwise indicated (*with Italics*)

(Bold indicates more successful economies according to Plate 3A)	A	B	C	D	E	F G H		
	TRADE				CAPITAL FDI inflows as a % of of GDP	SHARE OF FOREIGN AFFILIATES in production or turnover		
	Imports of goods as a % of goods GDP	Imports of services as a % of services GDP	B minus travel and transport	Internationalisation ratio of services (Goods = 100) (B / A) * 100		All manufacturing	Services: two examples Telecommunic. services	Computer services
Japan	19,0	4,8	2,3	<b>25</b>	<b>0,1</b>	1,8	0,1	
Italy	54,9	8,1	3,7	<b>15</b>	<b>0,1</b>	22,4	0,0	7,7
Germany	65,9	8,8	3,8	<b>13</b>	<b>0,9</b>	10,8		
<b>United Kingdom</b>	78,1	8,3	2,4	<b>11</b>	<b>4,7</b>	31,4	4,1	35,8
Canada	95,8	10,1	5,1	<b>11</b>	<b>2,8</b>	50,3		
France	68,2	6,6	2,9	<b>10</b>	<b>2,0</b>	29,2	1,6	13,1
<b>United States</b>	41,5	3,1	1,2	<b>7</b>	<b>2,3</b>			
<b>Ireland</b>	110,1	<b>47,6</b>	36,7	43	<b>2,7</b>	72,2	0,0	19,9
<b>Austria</b>	89,2	<b>22,0</b>	5,7	25	<b>2,8</b>		1,8	6,9
Iceland	78,1	<b>20,4</b>	4,1	26	<b>1,4</b>			
Czech Republic	114,0	<b>20,0</b>	10,9	18	<b>4,6</b>	27,6	1,4	23,6
<b>Belgium-Lux.</b>	211,9	<b>18,4</b>	9,7	9	<b>8,3</b>			37,0
<b>Netherlands</b>	135,0	<b>18,1</b>	8,2	13	<b>6,0</b>	31,7	3,4	22,8
<b>Korea</b>	63,4	<b>16,2</b>	8,2	26	<b>1,7</b>			
<b>Norway</b>	71,4	<b>16,0</b>	5,8	22	<b>2,5</b>	24,1		33,5
Hungary	135,9	<b>14,3</b>	9,1	11	<b>4,1</b>	73,0	62,0	22,5
Sweden	87,4	<b>14,1</b>	6,3	16	<b>8,3</b>	21,9	8,4	21,3
New Zealand	67,2	<b>13,3</b>	4,7	20	<b>3,6</b>			
<b>Denmark</b>	91,7	<b>12,3</b>		13	<b>3,7</b>			
Portugal	88,2	<b>11,0</b>	4,3	13	<b>1,7</b>		28,8	15,6
Finland	68,5	<b>9,8</b>	4,7	14	<b>9,7</b>	16,2	1,8	25,7
Turkey	46,9	<b>9,1</b>	5,1	19	<b>0,5</b>	11,2		
Switzerland	82,5	<b>8,2</b>	2,7	10	<b>1,8</b>			
Spain	70,2	<b>7,7</b>	4,2	11	<b>1,6</b>			
Poland	75,6	<b>7,6</b>	4,9	10	<b>4,2</b>	33,8	1,6	22,4
<b>Australia</b>	58,7	<b>7,0</b>	2,4	12	<b>1,9</b>			
Greece	76,6	<b>6,2</b>	2,2	8	<b>3,1</b>			
Mexico	87,3	<b>4,8</b>	2,6	5	<b>2,5</b>			
Slovak Republic								
<i>Larger economies</i>								
Mean	60,5	7,1	3,1		1,8	24,3	1,5	18,9
Standard deviation	25,0	2,5	1,2		1,6	17,0	1,9	14,9
SD/ Mean	0,4	0,3	0,4		0,9	0,7	1,3	0,8
<i>Smaller economies</i>								
Mean	90,9	14,5	7,1		3,6	34,6	12,1	22,8
Standard deviation	35,9	9,2	7,4		2,5	22,6	20,7	8,0
SD/ Mean	0,4	0,6	1,0		0,7	0,7	1,7	0,4

## **Plate 6. Development: Economic linkages of major OECD regions with less developed regions**

In spite of much progress, development and foreign aid since 1960 (especially in Asia), most nations outside the OECD area live in abject poverty. It is both altruistic and in the self-interest of developed countries to continue helping them.

We must however remember that economic development is neither inevitable nor a right. It is a long-term and arduous process requiring patient application of an extraordinary discipline which mostly depends on factors internal to a country. Outsiders, developed/wealthy countries in particular, can help. But aid *alone* is unlikely to be more than a palliative. As more countries recently embarked on international linkage-intensive strategies, this is precisely the time to strengthen a multilateral trading system and remove barriers to investment flows.

Plate 6 provides a snapshot on the high-income OECD countries' economic linkages with developing countries, focusing on the nexus of trade, investment and official development aid.<sup>13</sup> International trade is clearly the strongest component of economic interaction with the developing countries, and major OECD areas do not seem to differ significantly in terms of their overall "openness" to imports from outside the OECD area - though much regional disparity is hiding behind this broad picture. FDI outflows from the OECD area to developing countries today represent a linkage far stronger than official flows of aid. Official aid is of course a qualitatively different flow which can potentially target assistance to the needy and have a stronger impact on the host government. But in reality it also risks developing a relationship of mutual dependence between the recipient and the donor institution/country.

The recent awareness that good governance is a precondition of successful use of aid is good. But the view that governance in a foreign country can be improved with the promise of aid is based on an exaggerated view of how much foreigners can affect institutions and politics in a country. Indeed, to the extent foreign influence becomes the main motivation for better governance, it may sap further a sense of responsibility. Today a large number of poor countries remain dependent on the "development assistance community" for their public spending, balance of payments, and indeed, development ideas, which is an undesirable and unsustainable state of affairs. Besides, modernisation of institutional environment is closely intertwined with economic development. All of which argues for the primacy of privately-motivated economic links as an engine of development and the recognition of this fact by the countries determined to rapidly develop.

Private FDI in developing countries now far exceeds official investment, is a more nimble mechanism for transferring advanced technology, and can strengthen trade links further. But presently FDI represents a significant share of investment in only a small number of developing countries. OECD countries do not limit capital outflows. Removing barriers to FDI and putting in place framework conditions which attract FDI is a responsibility of developing countries.

### ***Recommendations***

The emphasis in the OECD Trade Committee on the Doha Development Agenda is welcome. Market access for developing countries, implying real market contestability in the OECD, is the most potent development path, and OECD work on capacity building would be valuable. There is also a continual need on the analytical side to update the evidence on how trade, investment and aid linkages with developing countries relate to development performance. Trade, DAC, CCNM and the Development Centre jointly could help clarify this nexus and develop a coherent and integrated OECD message.

There is also a need to make official aid clearly conditional on economic and political modernisation, including economic policies which favour outward orientation, notwithstanding the limits of influence.

From a measurement and policy making point of view, it would be worthwhile to develop a methodology to separate "humanitarian aid" (emergency relief, assistance to refugees, etc.) from "development aid" (foreign official contribution to investment in the developing economy).

BIAC appreciates the OECD work on promoting the right conditions for investment in Southeast Europe and believes that this could be supported by better targeted ODA. BIAC also looks forward to an opportunity to provide significant private sector input to the planned OECD study of FDI in China.

**Plate 6. Development: Economic Linkages of major OECD regions with Less Developed regions**

All data refers to 1999

	Absolute amounts (US\$billion)			As a percentage of GDP or GNI		
	US	EU-15	Japan	US	EU-15	Japan
<b>GDP</b>	9 190	8 293	3 105			
<b>IMPORTS:</b>						
<i>All commodities</i>						
from all countries	1 024	2 130	310			
from non-OECD	331	351	154	3,61	4,23	4,96
<i>Non-primary commodities</i>						
from all countries	820	1 501	169			
from non-OECD	257	219	81	<b>2,79</b>	<b>2,64</b>	<b>2,60</b>
<b>FDI OUTFLOWS</b>						
to all countries	152	352	21			
<b>to less developed countries</b>	23	60	5	<b>0,25</b>	<b>0,73</b>	<b>0,17</b>
<i>of which to High and Upper Middle Income</i>	11	41	2	0,12	0,50	0,08
<i>of which to Low &amp; Middle Income</i> <i>(total DAC outflow to China: \$3.9billion)</i>	11	19	3	0,12	0,23	0,09
to transition and advanced economies	16	25	3	<b>0,17</b>	<b>0,31</b>	<b>0,08</b>
total outflows to DAC recipients	38	86	8	0,42	1,03	0,25
<b>OFFICIAL DEVELOPMENT ASSISTANCE</b>						
Net disbursements to developing countries	9	27	15	<b>0,10</b>	<b>0,32</b>	<b>0,34</b>

## BACKGROUND NOTES AND SOURCES FOR THE TABLES AND FIGURES

### Plate 1A

GDP growth rate estimates and projections from *OECD Economic Outlook No. 71* [Online] (Spring 2002.)

### Plate 1B

Standardised Unemployment Rates up to and including 2001, from *OECD Historical Statistics 1970-2000* and OECD [Online] Employment Data Base. Conventional Unemployment Rates projections for 2002 and 2003 from *OECD Economic Outlook No. 71* [Online] (Spring 2002.)

### Plate 2A

Change in the annual Employment rates averaged over 1995-99 minus 1985-89. Source: OECD [Online] Employment Data Base. Changes in the market income of the bottom 30 percent of population by income. Source: Michael Förstner and Mark Pearson, "Income Distribution in OECD Countries", December 2000, mimeo.

### Plate 2B

Source: Background data from Programme for International Student Assessment (PISA), *Knowledge and Skills for Life. First Results from PISA 2000*, OECD, Paris 2001, Figure 7.7, page 173.

### Plates 3A and 3B

GDP per capita growth performance adapted from OECD (STI/EAS) *Science, Technology and Industry Scoreboard 2001* online data base. The second column in each cluster measures the change between 1989 and 1999 in the GDP per capita as a share of US GDP per capita (which is taken as 100). Hence, e.g., a country which was at 80 percent of US GDP per capita in 1989 and fell to 75 percent in 1999 would be shown as minus 5. Data on long-term GDP per capita growth was not available for Iceland, Luxembourg and the Slovak Republic in this data set. In each of the four clusters countries are ranked by the extent to which they have converged with the US GDP per capita level (the highest in 2001).

Composite index on Regulatory Quality (re-based as best OECD country = 100) from "Governance Matters II. Updated Indicators for 2000/2001" by Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, World Bank, Policy Research Working Paper #2772, February 2002. Available online at URL: <http://www.worldbank.org/wbi/governance/govdata2001.htm>

**Country notes on Plate 3A:** (1) Strong impact from the collapse of trade with the COMECON; (2) Capital surplus oil exporter; (3) Transition to market economy during '90s; (4) Exceptionally rapid catch up; (5) Loss of performance in the '90s; (6) Modest growth in the '90s.

### Plate 5

GDP, trade and FDI data from *OECD in Figures 2000* and 2001 Editions. Share of foreign affiliates in production or turnover from *Measuring Globalisation 2001. The Role of Multinationals in OECD Economies*, OECD, Paris, 2002. (A summary is accessible online at URL: <http://www.oecd.org/EN/document/0,,EN-document-7-nodirectorate-no-1-27622-7,FF.html>)

### Plate 6

Trade data from *International Trade by Commodity Statistics 1995/2000*, OECD, Paris 2002. FDI and official development assistance data from *Development Co-operation. 2001 Report, The DAC Journal 2002*, Volume 3, No.1, OECD, Paris, 2002 and the DAC [Online] Data Base. Less developed countries are the Part I of the DAC classification system. Part II includes high income aid recipients and the economies in transition.

## LIST OF ABBREVIATIONS

CCNM	OECD Centre for Co-operation with Non-Members
CIBE	OECD Committee on Industry and Business Environment
CIME	OECD Committee on International Investment and Multinational Enterprises
DAC	Development Assistance Committee
EPC	Economic Policy Committee
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National income
NAIRU	Non-accelerating inflation rate of unemployment
PISA	Programme for International Student Assessment
PUMA	OECD Public Management Service
STI	OECD Directorate for Science, Technology and Industry
STI/EAS	STI Economic Analysis and Statistics Division
WTO	World Trade Organisation

## END NOTES

- <sup>1</sup> The 2001 Discussion Paper can be downloaded from the BIAC Web site at URL: [http://www.biac.org/Textes/BIAC\\_TEXTES/BIAC\\_SubmissionsPDF/HIGH\\_LEVEL\\_Statements/Innovation\\_and\\_Global\\_Sustainable\\_GrowthFIN.pdf](http://www.biac.org/Textes/BIAC_TEXTES/BIAC_SubmissionsPDF/HIGH_LEVEL_Statements/Innovation_and_Global_Sustainable_GrowthFIN.pdf)
- <sup>2</sup> *Open Markets Matter. The Benefits of Trade and Investment Liberalisation*, OECD, Paris, 1998. *GATS: The Case for Open Markets*, OECD, Paris, 2002.
- <sup>3</sup> See Background Notes on Tables and Figures at the end of the statement for the sources of information used and explanatory notes.
- <sup>4</sup> A list of abbreviations is provided above.
- <sup>5</sup> For the purposes of this discussion "individuals" could mean households or individuals.
- <sup>6</sup> See Michael F. Förstner, Assisted by Michele Pellizzari, "Trends and Driving factors in Income Distribution and Poverty in the OECD Area", *Labour Market and Social Policy-Occasional Paper* No. 42, 2000.
- <sup>7</sup> Programme for International Student Assessment ("PISA") *Knowledge and Skills for Life. First Results from PISA 2000*, OECD, Paris, 2001.
- <sup>8</sup> *Benchmarking Industry-Science Relationships*, OECD, Paris, 2002.
- <sup>9</sup> Including Measures of non-tariff barriers having a measured impact on trade, restrictions on foreigners' ownership of business or equities, price controls, extensiveness and effectiveness of competition law, extensiveness and effectiveness of financial regulations, measures of bureaucracy, red tape, measures of decentralisation of government, independence and transparency of local government structures, etc. For more information consult the source: "Governance Matters II. Updated Indicators for 2090/2001" by Daniel Kaufmann, Aart Kraay and Pablo Zoido-Lobaton, World Bank, Policy Research Working Paper #2772, February 2002. Available online at URL: <http://www.worldbank.org/wbi/governance/govdata2001.htm>
- <sup>10</sup> 1998 figures are used in order to make trade and FDI data comparable with data on production by foreign-controlled enterprises, the latter of which is available up to 1998 only.
- <sup>11</sup> *Measuring Globalisation 2001, The Role of Multinationals in OECD Economies*, OECD, Paris, 2002 Volume I. Figure 13.
- <sup>12</sup> More detailed recommendations have been issued as part of the BIAC Statement to the OECD Liaison Committee with non-Governmental Organisations titled "The Challenge of Economic Recovery in a Dramatically Changed Environment. Doha: What's Next?", November 2001. Available on BIAC Web site.
- <sup>13</sup> There is a small discrepancy between the trade data (which refer to imports from outside the OECD area) vs. the ODA and FDI data which report flows to developing countries and territories according to the DAC reporting system definition, i.e., including some of the OECD member countries as recipients.