Business and Industry Advisory Committee to the OECD

Comité Consultatif Economique et Industriel Auprès de l' OCDE

OECD LIAISON COMMITTEE WITH INTERNATIONAL NON-GOVERNMENTAL ORGANISATIONS

BIAC CHAIRMAN'S STATEMENT

NOVEMBER 20, 2002

Mr. Secretary-General, Ambassadors, Delegates and distinguished leaders from the Secretariat, I am delighted to return to this Liaison meeting as Chairman of BIAC. In the years that I have come here in this and other capacities, I have viewed this opportunity to address the Council as a valuable checkpoint for our perspectives with regard to the Organisation's programme of work and policy trends.

This year especially we have a convergence of policy demands and choice that is particularly challenging. Successive shocks of bursting bubbles, terrorist strikes, wars and threats of war, oil price movements and blows to investor trust have shaken the global economy.

On the one hand, after a drop from peak performance, seemingly secure economic fundamentals have failed to ignite an anticipated recovery in the US. On the other, neither Europe nor Japan have been able to develop any traction in climbing out of their respective valleys.

Most economists have declared the need for an investment-led recovery. But, investors seem to be holding their breath. If I might be permitted a further use of this metaphor, we are all headed up hill. Stopping peddling and coasting is not an option.

So, the challenge that we share, business and government, is to reset our sights on growth. We need to clear the uncertainties from the path ahead. Some of those uncertainties are real and some imagined, some serious and some exaggerated.

While I will cover the economic policy aspects of the path to recovery, I would like to begin with the last of the shocks to which I referred, investor trust. Some commentators would have us believe that it has been crushed, not just the trust in stock analysts' predictions but trust in the marketplace itself and even in the capitalist system.

They do us no favours.

While I suspect that no one in this room would make or accept such a dark assertion, we have a responsibility to keep a steady hand in sorting out real policy failures from frustrations and over-reactions, as well as market failures from business failures.

All things considered, the justice of the marketplace was swift. Fraud, deception and self-dealing were uncovered and punished. The eyes of regulators are keener with regard to new and unfamiliar modes of business transactions. In the heat of hundreds, even thousands of energy trading transactions, sorting out meaningless swaps is a new skill.

Further, an overdose of caution on the part of investors, companies and individuals, have held business on the cost-cutting route to profitability. Investment in innovation is the more productive path, but that requires confidence. Where regulatory purpose turns to zeal, the return of confidence is painfully delayed.

Who would ever have imagined that the fraudulent misuse of the document retention policy of an accounting firm by a few individuals could result in the total evaporation of one of the most prestigious partnerships in the world?

Who would ever have imagined that questions regarding the use of complex risk management vehicles by the investment arm of global banks could cut their asset value by one third?

Fortunately, current law and regulation have been sufficient to redress most of the misconduct. And, the vast majority of business soldiers on firmly within the boundaries of reasonable behaviour.

The danger of over-reaction is that innovation in financial vehicles and legitimate challenges to accounting orthodoxy will be curtailed…that bureaucratic and administrative burdens will compound with no value…that well-intentioned demands for accountability impose conflicting requirements on companies and regulators alike.

Are there aspects of corporate governance that need improved standards or regulatory vigilance? Absolutely!

The needs are quite different from country to country. Sometimes, the solutions are technical and obscure. Often, the “fixes” would be more appropriate as voluntary initiatives on behalf of business.

So, let us tread carefully and avoid attempting to regulate moral absolutes or swing the pendulum of oversight too far. Can any government legitimately say what represents too much pay? Too large a stock option?

Should significant differences in the structure of corporate Boards be ignored in the quest for standardisation in global firms? In most of these governance disasters, one must ask, “where was the Board?” In most OECD countries, plenty of regulation, standards and guidance already exist for the proper functioning of the Board.

Indeed, the last six months have provided plenty of additional motivation to current and aspiring Board members as to the gravity of the responsibility that they hold. Any Board member who has not seen, heard and understood, does not deserve a seat.

In 2003, we will have the opportunity to revisit the OECD Principles of Corporate Governance and we look forward to working with you to ensure the effectiveness of this important vehicle.

But fine-tuning guidance for corporate governance is a small part of the major challenge ahead of us. We are faced with irrational desperation in the minds of investors who should be fuelling the economic recovery. We must put the negative in its proper place and turn ourselves toward the positive.

How do we view the economic landscape?

In that regard, we would make the following summary statements:

While we still see some encouraging fundamentals, in addition to the list of shocks mentioned before, the list of factors making for an uncertain outlook has increased, including post-election confusion in Latin America and delays in economic reform programs are all likely to negatively impact economic activity.

Employment and income stability are central to maintaining even this pace of global expansion.

Uncertainty particularly makes a sustained capital spending rebound vulnerable, especially in the face of relatively low capacity utilisation. With the slow upswing, capital goods investment, including IT, has already been taking a long time to fully respond. Recovery in the telecoms sector does not appear to be on the horizon. Growth in the 2-3% range emerging from the deep global deceleration has been insufficient to lift capacity utilization.

In the US, the economic recovery through three quarters is on track, running at a 2.3% clip ahead of last year. The fourth quarter should add to that performance even though consumer spending is slowing as higher debt, equity market weakness and uncertainty prevail. Federal government outlays for homeland security are leading to a $150 billion budget shortfall which supports near-term growth, but adds little to productivity.

Profits have rebounded while capital goods orders and shipments continue to improve slowly, suggesting further capital equipment investment ahead. IT orders and shipments are up an average 6.6% over the past three months. Spending on computer equipment and software has held up well, at 30% of total capital spending. But, outlays are constrained by low capacity utilization, currently 76% compared to an 82.5% historical average, and by global uncertainty.

In Europe, the near-term outlook has been significantly lowered, some consider it grim. There is still recovery but it is narrowly based and fragile. Confidence measures are not improving due to continued global economic and stock market weakness along with the other uncertainties. Indicators point to slower 3Q growth, and there are no visible signal of upward momentum moving into the current quarter.

Germany, Italy, the Netherlands and Switzerland have the weakest activity, flat with no momentum, better in France and Spain, while the Nordic region and Ireland show the strongest growth. Slow personal income growth, adjusted for inflation, has limited gains in domestic demand. Relatively low productivity gains combined with rising wages have raised unit labor costs and squeezed profits, therefore business investment. Labor markets are correspondingly weak.

A case can be made for central bank easing although the stickiness of core inflation around 2.5% will figure in the deliberations.

The U.K. economy expanded a robust 0.7 % in 3Q02 over 2Q02, or 1.7% over a year ago. Growth is due to consumer spending, the service sector, a booming housing sector boosted by a scant 3% jobless rate and heavy lending activity. Business investment continues to languish.

In Asia, Japan's recovery from recession hinges on cleaning up non-performing loans, amounting to 8% of GDP. While liquidity has been expanding it has been absorbed by banks trying to cover their capital adequacy requirements. A new economics team has committed to a solution which will apply public funds, much resisted in the past. Meanwhile, exports are driving growth aided by yen depreciation, now 122 to the U.S. Dollar. But Japan's stubborn trade surpluses with the U.S. and Europe limit the extent of yen weakness and, therefore, export gains.

Interestingly, China is drawing a large portion of the world's FDI, $55 billion, as opposed to the US, which has dropped from $125 to 44 billion.

In contrast, Australian economic growth has been robust with broad-based exports and domestic demand, including business investment. Housing has been especially strong and prices are soaring, raising fears of a bubble. Slow growth in Australia's main export markets will eventually take a toll bringing growth down to more sustainable, non-inflationary 3.0%.

It is interesting to observe the linkages in the movement of asset values between Europe and the US. We believe that this is an indicator of the interdependency derived from a decade of heavy foreign direct investment, an indicator which is rightfully under study by the OECD Economic Policy Committee.

With regard to the broader array of OECD work, we have updated our BIAC Discussion Paper, "Innovation and Global Sustainable Growth." We applaud the important work under way and exhort the Secretariat and the Committees to keep their eyes and resources trained on the promotion of the liberal market-based economy. The race is not yet won.

To return to the subject of investor trust, it is important that both business and government take visible and firm steps to restore confidence in the ownership of productive assets and participation in economic recovery. Equity markets will respond and, in turn, buoy the propensity to invest. Ownership is the way "up" in economics. It is also the way up in politics. Talking ourselves down is doubly self-defeating.

So, let us move onward and upward, together, with prudence and resolve.

Thank you.