

PO-CH/NL/0094 PT A



Part A

**CONFIDENTIAL**

(Circulate under cover and notify REGISTRY of movement)

Begins : 21/4/87

Ends : 4/5/87



PO -CH /NL/0094



PART A

Chancellor's (Lawson) Papers:

MEETING OF THE  
ORGANISATION FOR  
ECONOMIC COOPERATION AND  
DEVELOPMENT MAY 1987

PO -CH /NL/0094

PART A

PART A

Disposal Directions : 25 Year

*Phillips*

1/8/95



CONFIDENTIAL

ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

CONFIDENTIAL

Paris, drafted: 17th April 1987

dist.: 21st April 1987

C/MIN(87)3(Final)  
Synthesis Report

Or. Engl.

COUNCIL  
AT MINISTERIAL LEVEL

STRUCTURAL ADJUSTMENT AND ECONOMIC PERFORMANCE  
SYNTHESIS REPORT

(Note by the Secretary-General)

At its meeting in 1985, the Council at Ministerial level requested the Secretary-General to undertake a study of Member country experiences in the field of structural adjustment and to provide a report to its meeting in 1987 [C(85)62, paragraph 8]. This is a synthesis report responding to that request. The complete study also includes a technical report, comprising ten chapters and an "overview" which have been circulated separately.

CONFIDENTIAL

W0483H/0485H

4121



TABLE OF CONTENTS

INTRODUCTION .....	3
I. STRUCTURAL FACTORS AND ECONOMIC GROWTH .....	7
A. The main sources of strong growth .....	7
B. The deterioration in economic performance .....	15
C. Patterns of economic, social and institutional linkages ...	25
II. STRUCTURAL POLICIES : A PROGRAMME FOR CHANGE .....	38
A. Increasing competition in product markets .....	39
1. Agriculture .....	39
2. Industrial adjustment .....	41
3. International trade .....	49
B. Improving the responsiveness of factor markets .....	52
1. Financial markets .....	52
2. Labour markets and collective bargaining .....	55
3. Education and training .....	61
C. Efficiency and effectiveness in the public sector .....	65
1. Regulation and the scope of the public sector .....	66
2. Social policies .....	69
3. Taxation .....	71
III. THE STRATEGY OF REFORM .....	72
A. Advancing fairness and equity .....	73
B. A broad approach to action .....	75
C. The international dimension .....	76



## INTRODUCTION

1. Economic circumstances are in many respects more favourable to strong growth in the OECD area now than at any time in the recent past. The abatement of inflation and the substantial decline in prices of internationally-traded energy and raw materials have created renewed room for increasing incomes and creating jobs. Rapid technological progress has made possible a wide range of new products and processes, while a decade of far-reaching structural change in industry has rendered many firms more efficient. Yet the OECD economies' response to these opportunities, though uneven, remains largely sluggish and falls well short of earlier expectations.

2. A shortfall of economic performance relative not only to what was desired but also to what had earlier been thought feasible and even likely, has been an enduring feature of the last fifteen years. In the early 1970s, most observers -- including the OECD -- confidently expected the decade which lay ahead to yield output growth even more rapid and sustained than that which had characterised the 1960s. Again, in 1977, a special study by the OECD concluded that the poor showing of recent years was likely to be only temporary, and that a return to strong growth was possible and indeed probable. Most recently, improvements in the OECD area's terms of trade have only slowly been translated into gains in income and employment.

3. The gap between outcomes and expectations has partly reflected developments over which policy-makers in the OECD area have little control -- most obviously the successive oil price increases which precipitated the sharp recessions of 1974-75 and 1980-81. But the importance of the external shocks should not be exaggerated; for while they doubtless worsened and generalised the deterioration in performance, there were earlier signs of a sharp falling off in employment expansion, notably in Europe, and (though the evidence is more mixed in this respect) of a slowing in the rate of growth of productivity. Moreover, developments outside the OECD area cannot account for the persistence of poorer performance, and for the disappointing response when external factors turned broadly favourable. Nor can the external shocks explain the differences in individual OECD economies' response -- differences



most starkly visible in the behaviour of employment, but also evident in output trends and inflation.

4. Rather, the sources of the broader deterioration and of the national differences must be sought primarily within the OECD economies: in factors which limited individual capabilities and collective outcomes.

5. Though their precise impact is difficult to gauge, it cannot be doubted that macroeconomic policies played an important role. With hindsight, it can be argued that policies in the early 1970s were too expansionary, and in the 1980s possibly contractionary for too long; and inconsistencies between the policies pursued in different countries clearly created imbalances which made good performance harder to sustain. Yet those who had decisions to make did not have the luxury of hindsight to draw on; and the policies put in place reflected perceptions of what could be achieved, and of how rapidly individual economies could grow before running into internal and external constraints. It may be that at times the perceptions were mistaken -- or poorly translated into effective policy, especially at an international level; but this does not detract from the fact that the task of macroeconomic policy-making would have been considerably easier had economies and indeed electorates been more responsive to changing realities -- had wage and price inflation been controllable at a lower cost in foregone output and lost jobs, had firms and workers identified promising activities sooner and moved more readily from those in decline, and had expectations of public action and public action itself (and hence outlays) adjusted more quickly to new constraints.

6. These factors are eminently structural. They refer to the capacity of economies, institutions and societies in general to adjust to changing circumstances, to create and exploit new opportunities, and on that basis deploy and redeploy resources. It is not possible to put a number on this capacity; and its relation to macroeconomic performance is clearly one of interaction, rather than mechanical causation. Yet it seems reasonable to believe that this capacity was strong and contributed to the rapid growth of the first post-war decades; but then weakened as growth peaked. But why might this capacity have declined? And, even more importantly, how can it be restored?



7. These questions are at the centre of this report. Its primary concern is with the structural features of national economies -- the supply and allocation of factors of production, the market for goods and services, and the taxing, spending and regulatory functions of the public sector -- and with the flows of international trade and investment. Though increasingly recognised, the role of these microeconomic processes in shaping aggregate performance has not been adequately taken into account in the overall framing of economic policy; and analysis of this role and its policy implications is complicated by the almost bewildering range and diversity of issues involved.

8. This report seeks to pull these threads together. Drawing on the Secretariat's Technical Report on Structural Adjustment and Economic Performance (where the supporting analysis and data can be found), it examines broad trends in the structural components of the OECD economies, the effects which microeconomic policies have had on each of these, and the implications for economic performance; and it advances recommendations for policy reform: for how policies could be reoriented to best contribute to the goal of job-creating, non-inflationary growth.

9. The issues dealt with center on the policies of governments and their effects on efficiency. The role of government in society needs to be regularly reviewed; it is only natural that the balance between the public and private sector, and indeed the interplay of public action and private initiative, be adapted to changing circumstances. If the public sector has acquired great weight in modern societies it is because the demands to which it responds have been so strong; but this makes all the greater the importance of enhancing the efficiency and effectiveness of public policy -- in its conception, administration and implementation.

10. The changes required will of course vary from country to country, in line with differing traditions and circumstances. Yet these differences, though they make particularly hazardous the generalisations inevitable in a report such as this one, do not detract from the general trend -- a trend to review more critically policies long taken for granted or considered too difficult to change; a greater willingness to recognise that public policy is likely to be most effective when it is mindful of the limits to what can be



done; an acceptance that even the best intentioned policies may produce perverse outcomes as contexts and aspirations change.

11. The task of assessing the areas where policy reform is most urgent and desirable can only be manageable if the topics to be covered are clearly set out. This report does not pretend to be encyclopaedic; and two broad issue areas which fall outside its terms of reference are worth special mention.

12. To begin with, the report, and the studies on which it is based, deal only with the OECD Member countries. Nonetheless, it seems reasonable to suppose that many of the policies advocated in this report have broader applicability.

13. Secondly, the report concentrates on microeconomic policies. This is not to deny the importance of macroeconomic policy, nor to play down the interactions between the decisions and conduct of individual economic agents and the broader monetary and fiscal framework. But in the day-to-day pressures of economic policy-making, there is a constant danger that the longer term evolution of economic structures will be neglected; and that the very diversity of these structures, and the range of policies which act on them, will hinder the development of a consistent and overall view.

14. The report begins by examining the microeconomic aspects of postwar economic growth. It concentrates on the factors that contributed to the outstanding performance of the 1950s and 1960s, but that waned in later years, at least partly because of the effects of public policies; and examines the differing ways in which the OECD economies responded to the slowing of growth (Part I). It then sets out a programme for the reform of microeconomic policy across a broad range of areas, with the objective of facilitating sustainable growth (Part II). Finally, it examines the relations between the reform of microeconomic policy and broader social and economic goals (Part III).



## I. STRUCTURAL FACTORS AND ECONOMIC GROWTH

15. From 1950 to the first oil price shock in 1973, real GDP in the OECD area increased by an average of nearly 5 per cent a year, two and a half times more rapidly than in the four preceding decades and approximately twice as rapidly as in the years from the oil price shock to today. A number of microeconomic factors bolstered this performance (Section A) -- factors which either eventually ceased to operate, or came to operate less fully (Section B). The consequent deterioration in economic performance was associated with quite differing patterns of structural change within the OECD area; but each of these patterns contained an important element of unsustainability, increasing the adjustment burden the OECD economies will need to face in coming years (Section C).

A. The main sources of strong growth

16. Over the longer term, economic growth arises from the interplay of incentives and capabilities. The capabilities define the best that can be achieved; while the incentives guide the use of the capabilities and, indeed, stimulate their expansion, renewal or disappearance. In the advanced economies, the capabilities refer primarily to the supplies of human capital, of savings and of the existing capital stock, as well as to the technical and organisational skills required for their use; the incentives originate largely in product markets and are then more or less reflected in markets for factor supplies -- thereby determining the efficiency with which capabilities are used. Both incentives and capabilities operate within an institutional framework: institutions set rules of the game, as well as directly intervening in the play; they act to alter capabilities and change incentives; and they can modify behaviour by changing attitudes and expectations.

17. Seen in this schematic perspective, the freeing of market incentives and the strengthening of capabilities were critical factors in the exceptionally strong growth of the first post-war decades. From the standpoint of today's world, it is difficult to realise the extent to which price signals had become distorted in the years between the two world wars;



but three factors -- which contributed to the poor performance of the 1920s and 1930s, and the reversal of which was a key element in postwar growth -- stand out.

18. The first -- and in many respects the most significant -- was the persistence of far-reaching barriers to trade after the end of the first World War, and their further rapid spread in the late 1920s and then 1930s. By the eve of World War II, the ratio of international trade to world output had been halved from its previous peak; and much of the trade which took place occurred under state-to-state arrangements in which market forces played little role.

19. Secondly, the move to protectionism coincided with and indeed permitted the widespread cartelisation of domestic and international industry. In most European countries and Japan, domestic cartels, frequently mandated by national policy, controlled markets for products ranging from coal to cigarettes; and -- though more difficult to organise and maintain -- effective international cartels were at work in a wide span of world markets, including coal, steel and for some time rubber among the traditional industries and electrical products and chemicals among the new.

20. Finally, international capital flows -- which had been of enormous significance in earlier years -- became subject to a tightening web of private and public controls; so that foreign direct investment -- a key vehicle for transferring technology and introducing new competition -- declined from some 4-5 per cent of total world investment at the turn of the century, to well under 1 per cent.

21. Post-war reconstruction swept away many of these barriers. By the mid-1950s, the process of trade liberalisation was well in train, with quantitative restrictions largely removed and tariffs declining by some 10 percentage points on average. The formation of the European Economic Community, which in time became the world's largest common market, provided further impetus to the dynamic of market opening, a dynamic which largely culminated in the Kennedy round of multilateral trade negotiations. Liberalisation also extended to capital movements and restrictions on foreign



direct investment were substantially relaxed. More open trade, together with actual or potential entry of new competitors through foreign investment, heralded the end of domestic and international cartels -- a process accelerated by the shift in many countries to more active competition policies.

22. Not only did these changes bring price signals more closely into line with world market opportunities; they also changed the realities of competition. This was partly because open markets drastically reduced the leeway any producer had to ignore change and postpone adjustment -- for delay would bring the loss of market share and the threat of takeover or liquidation. But it was also because liberalisation created powerful new incentives: incentives to build larger, more efficient plants, which could be exploited only through export sales; incentives to shift to more specialised products, justified by being able to serve demand in several countries at once; and incentives to invest in developing new products and processes, because the associated high fixed costs could be spread over the world market as a whole.

23. The response to these incentives was visible in the spectacular growth of world trade and in its changing composition. Table 1 sets out estimates of the ratio of imports to supplies of finished manufactures for twelve OECD countries over the course of this century. This ratio, which in 1950 stood at less than half its previous peak, trebled over the subsequent two decades. Much of this growth took place in industries characterised by significant economies of scale, pervasive product differentiation and/or far above average investment in research and development -- industries whose combined share in OECD manufactured imports had by 1973 exceeded 60 per cent. At the same time, foreign direct investment was reshaping industrial structures, notably through the transfer to the European market of the technical and (perhaps most importantly) organisational know-how pioneered in the mass market of the United States -- and it is worth recalling that throughout the late 1950s and early 1960s, United States firms were establishing subsidiaries in Europe (most frequently through takeover) at a rate exceeding one a day.



Table 1  
 IMPORT CONTENT OF "SUPPLIES" OF FINISHED MANUFACTURES (1)  
 1899-1984  
 per cent

	Maizel (2)					Batchelor (2)		OECD estimates (3)			
	1899	1913	1950	1959	1963	1963	1971	1971		1984	
								A	B	A	B
United Kingdom (4)	16	17	4	6	7	9	16	11	16	28	36
France	12	13	7	6	12	12	19	15	19	24	31
Germany(5)	16	10	4	7	10	9	17	14	16	23	29 (6)
Italy	11	14	8	8	13	13	15	11	16	17	25
United States	3	3	2	3	3	3	8	9	9	24	24 (7)
Japan	30	34	3	4	6	4	5	4	5	6	7
Total large	9	8	3	4	6	6	11	10	11	20	23
Belgium-	26	24	14	15	24	25	34	38	46	48	60
Luxembourg											
Netherlands	-	-	33	33	39	35	44	38	46	53	61 (6)
Norway	-	35	33	34	34	35	44	46	52	56	60
Sweden	8	14	12	17	17	18	22	31	35	38	45
Canada (4)	20	23	16	20	18	22	32	33	36	45	49
Total small	-	-	18	21	24	25	33	36	41	47	53
Total industrial	-	10-11	5	6	8	8	14	13	15	23	26

1. "Supplies" are defined as gross value of production of non-food manufactures free of duplication, plus c.i.f. value of imports of finished manufactures (goods not normally subject to further processing). The figures of Maizel and Batchelor et al, were based on production-data (value added) which were inflated by the ratio of net output to gross output (excluding taxation and items sold by one part of the manufacturing sector as inputs to another part), both valued at factor costs. The data on intra-manufacturing purchases and sales which are needed for computing this ratio were available only for a limited number of countries in individual years. Maizels based his calculations partly on the ratios which he had been able to compute for individual countries (mainly relating to the early 1950s) and partly on a "rule of thumb". Batchelor et al used a

CONFIDENTIAL

CONFIDENTIAL



Table 1 Notes (continued)

regression based on the investment/output ratio to calculate gross output. [For a further exposition to the methodologies used, see Batchelor (1980)]. The OECD data for production are based on gross domestic product at market prices for total manufacturing excluding food, beverages and tobacco (for the United Kingdom and Canada gross domestic product for total manufacturing at factor costs) and are converted in US dollars using purchasing power parities and dollar exchange rates respectively. Import data are based on c.i.f. value of imports of "finished manufacturers" which is a separate category in the Brussels Nomenclature and were converted to and calculated on the SITC rev. 1 basis. The import content ratio is based on current prices because volume data for production and imports of non-food finished manufactures, free of duplication, are not available.

2. Prices of 1955.
3. Current prices; first column (A) conversion with purchasing power parities for GDP and second column (B) conversion with dollar exchange rates.
4. For United Kingdom and Canada gross domestic production of total manufactures for OECD estimates.
5. Federal Republic of Germany from 1950 on.
6. For Netherlands and Germany GDP for 1984 is calculated by the ratio non-food manufacturing/total manufacturing of the latest available year, since for 1984 no breakdown was available.
7. Figure for 1983, included in total for 1984.

Source: Maizels, A., Industrial Growth and World Trade, Cambridge 1963; Batchelor, R.A. et al, Industrialisation and the Basis for Trade, Cambridge 1980; OECD, National Accounts; Compatible Trade and Production Data Base.

CONFIDENTIAL

CONFIDENTIAL

- 11 -

C/MIN(87)3(Final)  
Synthesis Report



24. The links are difficult to quantify and probably impossible to prove. But it seems plausible to suppose that the need to adjust to international competition, and the high perceived returns from doing so, underpinned what perhaps most distinguished post-war growth from the virtual stagnation of the inter-war years: the trebling in the rate of growth of the non-residential capital stock, with capital accumulation apparently being quickest in the sectors most exposed to world trade. Equally, the evidence (though again incomplete) suggests that it was in the export sectors that the greatest gains in productivity were made -- gains which fed and sustained overall productivity growth that on average was more than twice as rapid as in the eight preceding decades. The experience of those OECD countries which retained relatively high levels of trade protection during the first two post-war decades -- such as Australia, New Zealand and Spain -- highlights these effects: for though their economic fortunes differed in important respects, they shared a uniform tendency for productivity growth to fall short of the area-wide average.

25. The extent of the response to enhanced incentives reflected partly the confidence that decision-makers in industry and finance could place in the resilience of the new market conditions -- particularly in the field of international trade. The rapid spread of trade barriers in the inter-war period -- generally on a discriminatory basis -- had not only distorted relative prices; it had undermined firms' capacity to plan. Despite occasional setbacks, the continuing focus on liberalisation in the post-war years created a quite different climate for private decision-making -- a climate sustained by the GATT and the OEEC (subsequently the OECD), and by the phasing out of most quotas and the shift to the binding of tariffs (a move which made it costly for countries to withdraw tariff reductions). This ensured that individual firms' gains in efficiency would go rewarded through larger markets, lower unit costs and higher margins -- so that the benefits which could be obtained from new investment would outweigh the risks.

26. But if investment, output and employment responded so strongly to the signals coming from domestic and international demand it was also because the capabilities -- in terms of human, physical and technical capital -- were there and could be mobilised through factor markets that were markedly more efficient than in earlier years.



27. The most obvious cases were technology and organisation. In the early 1950s, the gap between the United States and the other advanced economies in the application of new technologies and organisational methods was large, as were the differences in capital stock. These were reflected in levels of industrial productivity (measured by GDP per manhour) in most countries that were less than half those in the United States. An enormous backlog of innovations existed that could be drawn on through acquisition, imitation or foreign investment as economies grew.

28. But capital and labour markets had also been reshaped. The efficient mobilisation of savings was facilitated first by the early post-war success in bringing inflation under control; and secondly by the recovery and extension of financial systems which had been weakened by the succession of internal instability, the shift to a war economy and the widespread rationing of credit during reconstruction. But once immediate reconstruction came to an end, the financial reforms of the late 1940s and early 1950s and the easing of credit rationing permitted significant financial innovation -- in particular, the expansion of household credit, which helped fuel the rise in demand for consumer durables, notably cars, and in home ownership. And after 1958, currency convertibility rapidly revived international capital markets, which had largely collapsed in the early 1930s.

29. The changes in labour markets were even greater. Seen from an economic perspective labour markets carry out both macro and micro functions. Their macroeconomic role consists of maintaining a balance between the average level of wages and economies' "capacity to pay" -- in other words, of sustaining a sufficient level of profitability to finance the investment required to support high levels of employment and raise living standards. The microeconomic function involves allocating labour among competing uses and ensuring that it is efficiently utilised where it is employed. These functions are largely exercised through systems of industrial relations -- that is, institutionalised procedures by which wages and the conditions of employment are set and work practices determined; and the functioning of these systems depends both on their internal structure and on the broader economic, social and indeed political environment -- so that it is these which shape the quality of the outcomes. Overall, a well-functioning labour market,



with low levels of unemployment and reasonable internal and external mobility, is conducive to sustained productivity growth and smooth structural change. The circumstances and developments of the first two post-war decades were largely favourable in these respects.

30. Following initial turbulence, industrial relations moved to a more settled pattern, broadly supportive of moderate wage growth and of improved labour utilisation. Especially in the Nordic countries, depression followed by war had encouraged a rationalisation and centralisation of bargaining structures, sustained by a broad social consensus about national economic and social goals. In other countries -- Germany, Austria and Japan -- free labour movements adjusted to the responsibilities and opportunities of economies rapidly emerging from a legacy of destruction. In yet others, internal divisions between unions and labour market constraints were the primary factors affecting collective bargaining.

31. At the same time, and virtually throughout the OECD area, domestic and international migration made labour not only abundant but mobile -- facilitating the growth of new firms and industries. Between 1950 and 1973, there was net immigration of nearly 10 million people into Western Europe, compared with a net outflow of 4 million from 1914 to 1949. And meanwhile, the shift out of agriculture alone swelled the urban labour force in the OECD area by more than 15 per cent. Urbanisation not only changed life-styles and aspirations -- it made for a labour force exposed to a broader range of employment opportunities, so that it became better able both to compare earnings and working conditions in different activities and to act on that information.

32. The willingness of workers to change regions, industries and firms not only reflected greater knowledge of what could be obtained -- it must also have been shaped by the perception that the risks of change were, on balance, worth taking. The critical factor in this respect was the steady approach to full employment -- a situation which, despite cyclical fluctuations, most European countries and Japan achieved by the early 1960s.



33. In this sense, microeconomic flexibility and macroeconomic performance were self-reinforcing: low unemployment facilitated both the widespread acceptance of technological and organisational change and the redeployment of labour; high levels of demand made investment in new plant and equipment easier to justify and to finance -- as did the increases in market size brought by international economic integration. Together, labour mobility and buoyant investment raised productivity -- leading to a rapid rise in living standards. This contained inflationary pressures in the labour markets; and these pressures were further eased by the opening of markets to international competition, whereby prices in world trade rose (over the period 1950-1973) at a rate only half that in domestic markets. This in turn made it possible for macroeconomic policy to permit or sustain high levels of demand -- creating a climate of confidence which further increased the incentives to invest.

#### B. The deterioration in economic performance

34. Yet, by the end of the 1960s, these "virtuous circle" effects were operating less fully -- and after 1973 hardly at all.

35. In retrospect, it is clear that many of the impediments to continued strong growth had developed during the period when performance was seemingly at its peak. The changes were partly macroeconomic in origin: The belief that aggregate demand policies could and would guarantee full employment may have lulled firms and workers into a false sense of security, slowing the adjustment to changing circumstances and accentuating inflationary wage and price increases. Repeated applications of stabilisation policies, giving rise to alternating surges of inflation and episodes -- however moderate -- of recession, further confounded market signals and made a steady course of wage growth and capital formation yet more difficult to maintain. But governments and observers remained over-optimistic about what policies could achieve long after the first signs of a deterioration in performance; and this created strong pressures for a continued expansion of entitlements, the acceptance of restrictive measures in product and factor markets, and the extension of spending commitments well beyond the margin provided by economic growth. At the same time, complacency in the face of the emerging difficulties was compounded by shifts in attitudes, and in particular, by the belief that economic growth was not an entirely desirable goal of policy.



36. Yet the constraints on economic performance were becoming increasingly tight. They emerged first and proved most intractable in the wage-setting behaviour of labour markets -- and notably in the weakened capacity of collective bargaining to generate wage settlements consistent with economies' aggregate capacity to pay.

37. This was partly because of exogenous factors reducing aggregate capacity to pay. After two decades of rapid growth, many European economies had largely exhausted the scope for raising productivity through "catching-up" with the United States; and by the mid-1970s, the same could be said of Japan. The room for absorbing wage increases through productivity gains was accordingly smaller; and strong pressures for an abatement of nominal wage growth also came from government concern at the trend rise in inflation. However, wage aspirations remained strong; and a slowing of nominal wage increases in the mid-1960s was followed by a wave of industrial militancy which placed great pressure on industrial relations systems in much of Europe, in Australia and (to a lesser extent) Japan. By the early 1970s, the unrest itself had calmed; but its legacy was a lasting one. This was most obviously so in the United Kingdom, France and Italy, where wages moved decisively out of line with national income. But elsewhere too, policy-makers' perceptions had been affected and a perhaps exaggerated weight was given to the social and political risks involved in wage restraint.

38. The first oil shock came on top of this legacy. The initial reduction in oil supplies itself involved only a minor and temporary physical constraint on growth; but the price effects proved far more durable and substantial. Their direct impacts were to strengthen inflationary tendencies and -- in most countries -- to precipitate current account difficulties. Both these were manifestations of a loss in countries' real national income as a result of the worsening in their international terms of trade. The fundamental task was to absorb this income loss while maintaining a level of profitability and capital formation sufficient to preserve employment and allow industry to adjust to changed energy market conditions. And it is in this respect that labour market institutions, and notably the wage formation process, proved most wanting -- though the difficulties proved far more acute in some countries than in others.



39. The second oil shock made these constraints more binding. Concern about a further acceleration in the wage-price spiral led monetary policies to a less accommodating stance, which succeeded in controlling inflation and in reducing the gap between the actual evolution of the wage share and the trend warranted by productivity developments; but notably in Europe, wage and price moderation was obtained at a high cost in lost jobs and foregone output.

40. The extent of these costs partly reflected a decline in the efficiency with which markets could respond to the new circumstances and absorb their consequences. In product markets, this decline was visible in the difficulties firms encountered in adjusting their operations to the new pattern of energy and labour costs and to shifting technological and commercial opportunities. Equally, in the factor markets, it was perhaps especially acute in the deepening segmentation of employment opportunities, though it was more broadly reflected in the lags with which capital and human resources were redeployed between uses. Finally, in the public sector, it was associated with the pursuit of courses of action which, though intended to ease the adjustment process, in fact made adjustment more difficult while imposing major burdens on the economy as a whole.

41. A loss in the efficiency of markets was partly the inevitable result of adverse macroeconomic trends -- and here again the interaction of microeconomic behaviour and the macroeconomic context is worth stressing.

42. The macroeconomic circumstances of the years subsequent to the first oil shock were certainly not such as to make industry's task easier in responding to changing product market signals. By the early 1970s, firms in the OECD area were used to an environment of relatively steady growth -- an environment where excess capacity was rapidly absorbed by the expansion of markets. Adjusting to persistently slower growth required a far-reaching reorientation in corporate planning and strategies; and this inevitably took several years. But macroeconomic policies did not always facilitate this reorientation by providing a stable, medium-term framework against which firms could set their bearings. Rather, in a first period, persistent inflation made changes in relative prices difficult to identify and emptied corporate accounting of much of its meaning. And as inflation abated, inconsistencies



in policies internationally came even more to the fore and induced exchange rate movements which distorted patterns of competitiveness and introduced new and pervasive uncertainties.

43. At the same time, the macroeconomic context reduced the efficiency of factor markets. For much of the 1970s and early 1980s, monetary conditions were such that high inflation was associated with low real returns on financial assets, which distorted financial markets by encouraging the development of instruments whose primary attraction was in hedging against unexpected increases in the price level. Moreover, the provision of finance for private economic activity, and notably for business, was compromised by the growing financing needs of the public sector -- needs which became all the greater as monetary policy shifted to a more restrictive stance while fiscal policy did so more slowly or not at all.

44. Equally, the rise in unemployment itself altered the behaviour of labour markets. Workers naturally became more reluctant to leave their current job to seek another -- so that labour mobility declined and with it the ease with which firms, industries and regions in difficulty could reduce employment. At the same time, high unemployment bred a defensive attitude to change -- a greater resistance to adopting and adapting to new ways of doing things, even within the individual firm; a growing demand for action by governments and trade unions to slow the pace of adjustment.

45. Finally, the changes in macroeconomic trends widened the gap between earlier public sector spending and taxing commitments and what could realistically be achieved. Short of a major review of entitlements, certain public outlays had to rise -- most obviously unemployment insurance, though there was also upward momentum in other areas of social expenditure. Given a continuing rise in expenditures, slower growth made some rise in the ratio of taxation to income inevitable (though many countries initially sought to postpone this by increasing public sector borrowing); and the virtually mechanical effect of inflation in systems of progressive income taxation, few of which were indexed, was to raise the marginal rates facing the average tax payer and to shift the balance of fiscal systems towards a greater reliance on the taxation of personal incomes.



46. But important as the effects of the macroeconomic context doubtless were, the adverse impacts on the efficiency and responsiveness of markets would have been smaller had the stance of microeconomic policy been different -- had microeconomic policy generally facilitated rather than hindered change. A wide range of policy instruments was involved; and the effects of each of these and the options for reform will be examined subsequently. But the broad feature of policies -- in product markets, factor markets and the public sector -- was to react to short term problems rather than to contribute to long term alternatives and to erode if not reverse the features which had made growth so strong in previous years.

47. To begin with, pervasive interventions in product markets both distorted the price signals facing firms and further undermined the predictability of the competitive environment. The changes were most striking in trade policy; for by the early 1970s, the postwar dynamic of trade liberalisation was largely spent. Exceptions to liberal trade had accumulated during the period of rapid growth; and despite some important gains in the Tokyo round, the onset of recession greatly aggravated the trend to protectionism. By 1983, non-tariff barriers affected some 27 per cent of the industrial countries' imports; and not only agriculture, but entire manufacturing sectors -- including textiles and clothing, steel, shipbuilding and automobiles -- had been largely removed from the ordinary discipline of the GATT.

48. The distorting effects of these changes in trade policy were compounded by policy measures in domestic markets. The highest points were reached in agriculture, where between 1979-81, the transfers to producers induced by agricultural policies were equivalent to 42 per cent of the sector's value added in the United States, 94 per cent in the EC and over 100 per cent in Japan (Table 2). Though not of this order of magnitude, industrial subsidies were also significant, as governments responded to pressures to assist firms, sectors and regions in difficulty, and became increasingly involved in promoting new areas of activity, frequently associated with high technology.

49. The effects of measures which distorted the signals and incentives coming from product markets were aggravated by policies which eroded the capability of factor markets to respond.



50. The trends in this respect were most pervasive in the microeconomic functioning of labour markets -- that is, their function of allocating labour among competing uses. The problems were multi-dimensional; and they arose not only from government policies narrowly defined but also from the operations of collective bargaining and, indeed, of secular economic and social trends. However, three facets, primarily of relevance to Europe, are of particular importance.

51. First, from the early 1970s to the early 1980s, a fairly widespread compression of occupational and industrial wage differentials occurred as a result both of collective bargaining and of government policies. This aggravated the position of the weakest elements of the labour force -- the unskilled young, the old, and those who had been without work for some time -- in a context which, given rising overall unemployment, was in any case unfavourable to them. The effects of shrinking wage differentials in terms of youth and long-term unemployment appear to have been quite limited in the countries where labour mobility has traditionally rested on an extensive system of vocational training, buttressed by active manpower policies; but they were acute in the countries where vocational education has a narrow base and large parts of the labour force have few certified skills -- so that the wage spread has traditionally served to share the risks employers take in recruiting workers whose skills they cannot judge at the moment of hiring. Though wage differentials reopened somewhat in the early 1980s, significant damage had been done, the job prospects of many having been durably set back by the loss of work experience.

52. Second, particularly in the mid- to late-1970s, legislative and regulatory restrictions were imposed in a number of countries on retrenchments, notably in larger firms. Though these measures subsequently were eased, their legacy proved longer lasting, for several reasons. To begin with, they frequently served as a basis for clauses restricting redundancies in collective agreements, which typically remained in place even after the legislation had been loosened. Moreover, by the time the controls were relaxed, the financial viability of a number of firms had been so eroded that the scale of the required manpower reductions was much increased. And finally, while engendering an illusory sense of security among those with



jobs, they may have contributed to creating a presumption in company management against employment expansion -- an excessive caution in recruitment which not only increased the required real wage adjustments overall, but particularly penalised the weaker elements in the labour force.

53. Third, restrictive work practices -- common in countries with a tradition of craft unionism, though especially far-reaching in unionised firms in the United States -- clashed with a need for greater flexibility and mobility in firms' internal labour markets. In a few countries -- for example, Italy -- the trend in the 1970s was for restrictions on internal mobility actually to tighten; but even abstracting from a worsening in the restrictive practices themselves, in many countries long-established ways of organising work conflicted with the requirements both of new process and product technologies -- which blurred the traditional distinctions between skills -- with shortened product life times and with the increased instability of economic circumstances.

54. In short, changes in the microeconomic features of labour markets tended to segment employment opportunities, increase firms' difficulties in adjusting employment levels -- not only downward but upward as well -- and make the efficient use of labour within enterprises more costly to achieve.

55. Finally, further modifications in the efficiency of resource use arose from the growth of the public sector, both as an economic agent in its own right and as a pervasive influence on incentives in the economy as a whole. Several aspects of public sector growth were particularly significant.

56. In the first place, there was a sustained rise in both public provision and finance of social services, notably in the fields of health, education and welfare. As demand for these services grew, and with it their share in societies' total use of resources, the efficiency of their provision became progressively more important. But growth tended to outstrip the management capabilities of the organisations responsible for providing service; and as problems emerged, the institutional framework -- the sheer size of the structures contributing -- made efficiency increases difficult to obtain and hindered these services' adaptation to changing circumstances. At the same



Table 2

COST OF AGRICULTURAL POLICY

Some Indicators of the Level of Cost Related to the Implementation  
of Agricultural Policy

Average 1979-1980-1981

	Cost Billion ECU	ECU/ha	ECU/per holding	ECU/per Agric. worker	Compared with			ECU/ total population
					GDP %	GVA %	FVAP %	
United States	26.2	61.3	10 810	7 453	1.3	42.1	22.1	115
Canada	2.5	35.9	10 248	4 203	1.2	42.6	23.7	103
Australia	0.6	1.3	3 708	1 558	0.5	9.2	6.1	43
New Zealand	0.2	17.0	3 458	1 778	1.4	13.7	8.5	79
Japan	23.8	4 361.5	5 110	4 090	2.9	104.3	57.6	204
Autria	1.4	384.2	4 584	4 786	2.6	60.4	39.9	188
EEC	56.5	613.4	11 437	7 465	2.8	93.2	49.9	208

GDP = Gross domestic product at market prices.  
GVA = Gross value added by agriculture at market prices.  
FVAP = Final value of agricultural production.

Note: The cost of agricultural policies is defined as the sum of public budgetary expenditures on agriculture (the "taxpayer costs") and of the subsidies to production financed by consumers (generally referred to as the "consumer costs"). This subsidy has been calculated using the method set out in Chapter 5 "Agricultural Policies" of the Technical Report on Structural Adjustment and Economic Performance but in the case of commodities for which a country is less than self-sufficient the tariff or external/internal price differential has been applied to production rather than consumption because in such cases the burden imposed on consumers is greater than the corresponding subsidy given to production.

Source: Secretariat estimates.

Basis statistics -- OECD, National Accounts; Labour Force Statistics; unpublished data on agricultural accounts.

FAO, Production Yearbook, 1983.

EEC, The Agricultural Situation in the Community, 1984.



time, there was a tendency to expand entitlements and financial commitments more rapidly than resources -- and to resolve the ensuing problems through administrative rationing and tighter budgetary constraints, rather than by reviewing the institutional arrangements involved.

57. It is difficult to assess whether the policies engendered broader losses by altering incentives to work or to save. The evidence in this respect is mixed, and there is certainly no simple correlation between economic performance and the scale of transfer payments -- or indeed any other single indicator of the size of government. Where the incentive effects of transfer payments were most significant, this was a result of their interaction with the tax system; and it is through the concomitant rise in the burden of taxation that the growth of public spending probably imposed its greatest economic costs.

58. In particular, marginal and average tax rates in many countries became very high; on average in the OECD area, by 1983, a two-child, single-earner married couple earning the wages of an average production worker, had a tax liability equivalent to 40 per cent of its income, while facing a marginal tax rate of over 55 per cent (Table 3). As tax rates rose, tax systems became increasingly complex and in many cases discriminated quite arbitrarily between different persons and activities. High marginal tax rates in the labour market encouraged the spread of tax avoidance and tended to reduce the supply of labour, especially among the more highly paid, who faced the highest marginal tax rates, but also among the poor, for whom taxes in combination with decreased social payments often created high effective rates (sometimes known as a "poverty trap"). And the taxation of capital income, by imposing quite different rates on competing investment projects, distorted the allocation of investment resources among alternative uses.

59. The combined result of the rise in taxation/GDP ratios was to increase the real resource cost of tax-funded government spending -- that is, to increase the return required from this spending for its benefits to exceed the costs of financing it through the tax system. Few systematic studies of these effects are available and their magnitude is in any case likely to differ significantly from country to country; but estimates suggest that \$1 raised



Table 3

TOTAL MARGINAL AND AVERAGE TAX RATES ON LABOUR USE  
AT AVERAGE PRODUCTION WORKER LEVEL  
per cent of total compensation including payroll taxes

	Single worker				Single-earner Married couple with two children			
	Marginal		Average		Marginal		Average	
	1979	1981	1983	1983	1979	1981	1983	1983
Australia	44.37	43.49	42.31	35.85	44.37	43.49	42.31	31.01
Austria	60.63	64.14	63.99	42.44	60.63	64.14	63.99	40.64
Belgium	64.61	65.95	66.86	52.83	62.19	62.05	61.65	48.12
Canada	43.32	45.09	42.72	36.83	41.12	42.96	42.72	29.17
Denmark	68.49	69.04	71.24	57.33	68.49	69.04	71.24	53.41
Finland	63.13	63.08	62.48	48.25	63.13	63.08	62.48	44.03
France	66.92	66.67	68.77	51.74	57.47	57.15	59.70	47.57
Germany	61.13	60.53	60.91	41.31	56.81	56.44	57.02	36.62
Ireland	55.51	57.78	70.21	51.68	55.51	57.78	63.80	44.91
Italy	56.28	59.54	62.66	50.25	56.28	59.54	62.66	48.88
Japan	40.50	43.90	43.68	23.73	35.93	39.41	39.93	19.05
Luxembourg	62.36	63.15	67.21	42.70	47.60	48.68	50.61	32.56
Netherlands	66.75	68.97	73.47	39.16	66.75	68.97	73.47	37.51
New Zealand	43.86	54.32	40.31	36.29	43.86	54.32	55.50	31.98
Norway	72.54	70.52	69.47	54.89	65.91	67.01	63.00	50.36
Portugal	44.03	46.75	46.94	37.77	40.08	43.25	44.29	37.05
Spain	43.94	45.38	46.66	38.64	43.94	45.38	46.66	35.52
Sweden	74.42	73.47	73.02	62.85	74.42	73.47	73.02	61.67
Switzerland	44.42	44.15	42.16	27.00	40.48	42.20	40.21	22.61
United Kingdom	51.53	53.44	54.53	42.17	51.53	53.44	54.53	38.97
United States	47.12	52.87	48.63	34.83	40.19	45.20	42.64	28.21
Average (Unweighted)								
OECD Europe	59.79	60.78	62.54	46.31	56.95	58.23	59.27	42.53
OECD Non-Europe	43.84	47.93	43.53	33.50	41.10	45.08	44.62	27.88
Total OECD	55.99	57.72	58.01	43.26	53.18	55.10	55.78	39.04

Note: The rates include payroll taxes, employer and employee contributions for social insurance, personal income taxes, and general consumption taxes and excise taxes.

Source: Secretariat Estimates.



through taxes may, at the margin, reduce national income by 10 to 15 cents and possibly considerably more, depending on the tax measures used, while the net overall cost of present tax systems could be in the order of 3 to 5 per cent of GNP. Yet -- at least partly because of inflation -- the need to monitor more carefully the quality of public outlays did not become apparent until the late 1970s, by which time a significant expansion of government commitments had occurred.

C. Patterns of economic, social and institutional interlinkages

60. In short, a broad range of microeconomic policies acted over the last decade in such a way as to reduce the efficiency of individual markets -- and slow the recovery from internal and external shocks.

61. But while the broad tendency to deteriorating performance was strong, the shape it took differed from country to country; and the outcomes diverged too, as varying macroeconomic contexts modified the effects of trends and policies in the microeconomy.

62. The most striking macroeconomic disparities were in unemployment rates. Graph 1 sets out average unemployment rates for individual OECD countries, for 1973 and 1986; the relative volume of the shaded area for each country is proportional to its share of the OECD labour force -- and hence to its contribution to the unemployment rate for the OECD area as a whole. It is clear from the data that the deterioration in area-wide employment performance was accompanied by a significant widening in the spread of unemployment rates, with the four larger European economies -- Germany, France, the United Kingdom and Italy -- accounting for fully 28 per cent of the rise in unemployment overall.

63. These disparities in macroeconomic outcomes were paralleled by significant differences in the pattern of resource use. Tables 4 and 5, which are based on national accounts data, present trends over the period 1970-83 in the sectoral distribution of output, employment and total factor productivity (a weighted index of the combined productivity of capital and labour) using two ways of aggregating sectors. The first -- set out in Table 4 --



classifies sectors into the three categories of high, medium or low growth according to their growth rates of value added relative to the average growth rate for all sectors. The second -- set out in Table 5 -- ranks sectors by degree of openness to international trade, the first grouping corresponding to the government sector, the second private services, the third to the activities largely based on natural resources (such as agriculture or minerals) and the fourth to manufacturing.

64. The data presented in the bottom part of each table are normalised so as to single out the extent of structural change -- that is, the change in the composition of domestic output relative to world output. This is done by expressing the data for each sector as the difference between the actual growth rate of that sector in a country (or group of countries) and the growth rate which could have been expected given that country's overall growth rate of value added and the growth rate of that sector across all countries. In other words, a positive value for a particular sector represents the average annual percentage amount by which that sector grew in a particular country above and beyond the growth warranted by that country's overall growth rate and the OECD-wide growth of the sector.

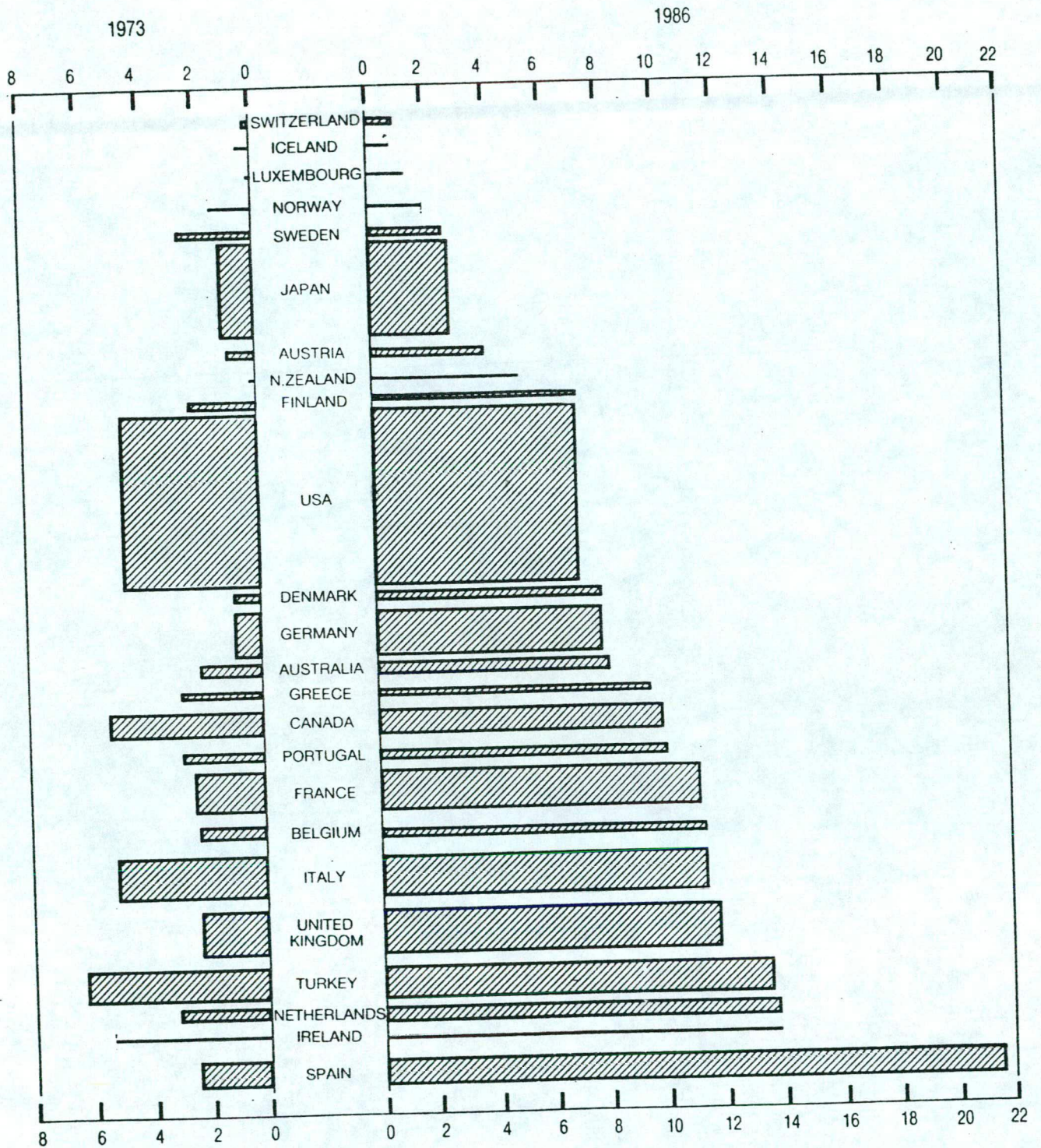
65. A general conclusion which emerges from the data is that demand trends did not differ significantly between countries. However, considerable differences occurred on the supply side -- in the way individual economies responded to the opportunities arising from demand and technological trends.

66. The most marked differences were those between Japan, the United States and Europe, with the Nordic countries departing somewhat from the main European pattern. These differing outcomes reflected interactions between microeconomic and macroeconomic factors and between markets, institutions and broader economic, social and even cultural contexts. The complexity of these interactions makes them difficult if not impossible to model; yet the broad patterns, suggestive of quite differing adjustment paths, can be identified.

67. Despite Japan's far greater dependence on imported energy and raw materials, several factors combined to speed adjustment and sustain macroeconomic outcomes which -- while well below performance in the previous



Graph 1. Unemployment Rates in 1973 and 1986  
(percentage)



Note: The volume represents the share of the labour force of the respective countries in the labour force of the OECD area in 1986.  
Source: OECD.



Table 4  
TRENDS IN OUTPUT STRUCTURE AND RESOURCE USE  
Sectors Ranked By Growth Rate of Value Added of All Countries Combined  
Average Annual Growth Rates for the Period 1970 to 1983

	NOR	BEL	DNK	FIN	SWE	FRA	GER	ITA	GBR	CAN	AUS	USA	JPN	EU5	NORDIC	TOTAL
Percentage Growth Rates of:																
VALUE ADDED (VOLUME)																
All sectors	3.03	2.55	2.30	3.48	1.99	2.99	2.30	2.28	1.15	3.21	2.73	2.59	4.66	2.29	2.51	2.82
Sectors with:																
Slow growth	2.10	0.32	0.51	2.18	0.17	0.40	-0.05	1.13	-1.30	1.85	1.51	-0.13	1.32	0.23	0.90	0.43
Medium growth	4.16	3.35	4.24	4.35	2.82	2.79	2.45	2.41	1.46	2.42	2.19	2.09	4.10	2.35	3.59	2.54
High growth	2.76	2.87	2.12	3.89	2.10	4.18	2.99	2.86	1.76	4.40	3.34	3.38	6.06	3.06	2.51	3.68
TOTAL FACTOR PRODUCTIVITY																
All sectors	1.12	1.60	0.99	1.87	0.71	1.39	1.37	0.66	0.49	0.29	0.91	0.38	1.52	1.06	1.04	0.75
Sectors with:																
Slow growth	1.91	2.48	0.97	2.22	1.37	1.29	1.57	1.61	0.28	0.16	1.57	-0.68	-0.23	1.35	1.60	0.38
Medium growth	1.41	2.34	1.34	1.52	0.18	1.52	1.29	0.70	1.24	-0.28	1.13	0.89	1.17	1.28	0.84	1.04
High growth	0.61	0.78	0.82	1.75	0.76	1.35	1.32	-0.03	0.17	0.77	0.54	0.41	2.26	0.80	0.89	0.85
CAPITAL STOCK																
All sectors	4.02	4.03	2.92	4.08	3.02	4.41	3.42	3.61	2.43	4.73	3.51	2.82	7.84	3.47	3.38	3.68
Sectors with:																
Slow growth	4.59	2.25	3.36	3.75	3.52	2.98	1.26	2.95	1.86	4.63	1.88	2.75	6.81	2.27	3.77	3.37
Medium growth	4.36	3.45	2.81	3.98	2.86	3.75	3.22	3.19	1.79	4.61	2.73	2.30	8.30	3.07	3.30	3.30
High growth	3.71	4.69	2.89	4.26	3.05	5.06	3.91	4.00	2.74	4.82	4.35	3.15	7.84	3.90	3.35	3.94
EMPLOYMENT																
All sectors	0.74	-0.07	0.55	0.51	0.60	0.22	-0.44	0.43	-0.37	2.34	1.27	1.58	0.79	-0.07	0.59	0.82
Sectors with:																
Slow growth	-1.68	-3.68	-2.97	-1.75	-2.97	-2.45	-2.84	-1.65	-2.85	0.54	-0.84	-0.18	-1.37	-2.41	-2.38	-1.49
Medium growth	2.26	0.80	3.40	2.77	3.01	0.81	0.86	1.76	0.18	2.23	0.39	0.75	0.94	0.79	2.95	0.96
High growth	1.04	1.05	0.20	1.05	0.36	1.55	0.17	1.69	0.13	3.17	2.39	2.36	1.95	0.77	0.56	1.76
<u>Memorandum Item</u>																
Labour force	2.04	0.75	1.24	1.25	0.86	0.79	0.22	0.82	0.42	2.89	1.80	2.32	1.03	0.54	1.23	1.37



Table 4 continued

	NOR	BEL	DNK	FIN	SWE	FRA	GER	ITA	GBR	CAN	AUS	USA	JPN	EU5	NORDIC
Difference between Actual and Calculated Growth Rates of:															
VALUE ADDED (VOLUME)															
Sectors with:															
Slow growth	1.39	0.25	-0.45	0.52	0.41	-0.14	0.08	0.82	0.18	0.75	1.10	-0.05	-0.86	0.25	0.44
Medium growth	1.28	0.99	2.26	0.77	1.13	-0.16	0.25	-0.03	0.56	-0.55	-0.28	-0.06	-0.33	0.17	1.33
High growth	-1.10	-0.57	-1.14	-0.85	-0.93	0.13	-0.14	-0.37	-0.35	0.04	-0.27	0.03	0.36	-0.17	-1.00
TOTAL FACTOR PRODUCTIVITY															
Sectors with:															
Slow growth	1.24	1.33	0.63	0.47	1.22	0.38	0.92	1.16	0.37	0.01	0.71	-0.48	-1.28	0.77	0.89
Medium growth	0.09	0.54	0.21	-0.45	-0.53	-0.16	-0.39	-0.24	0.46	-0.62	-0.29	0.30	-0.59	-0.07	-0.27
High growth	-0.57	-0.89	-0.36	-0.12	-0.20	-0.10	-0.16	-0.66	-0.35	0.44	-0.23	-0.02	0.62	-0.31	-0.29
CAPITAL STOCK															
Sectors with:															
Slow growth	0.94	-0.71	0.80	0.28	0.97	-0.52	-1.37	0.07	0.60	0.70	-0.92	0.58	-0.30	-0.40	0.73
Medium growth	0.60	-0.35	0.18	-0.05	0.09	-0.35	0.16	-0.16	-0.19	0.01	-0.60	-0.13	0.73	-0.11	0.18
High growth	-0.51	0.32	-0.24	-0.06	-0.21	0.27	0.14	0.05	-0.01	-0.17	0.55	0.02	-0.38	0.12	-0.25
EMPLOYMENT															
Sectors with:															
Slow growth	-0.38	-1.51	-1.52	-0.40	-1.64	-0.56	-0.61	-0.34	-0.18	0.65	0.16	0.82	0.04	-0.47	-1.03
Medium growth	1.19	0.71	2.59	1.66	2.05	0.14	0.94	0.45	0.44	-0.06	-0.27	-0.74	0.03	0.50	1.98
High growth	-0.59	0.16	-1.26	-0.94	-0.96	0.21	-0.20	0.03	-0.21	-0.19	0.01	0.13	-0.03	-0.05	-0.96

Source: Secretariat Estimates.

CONFIDENTIAL

- 29 -

CONFIDENTIAL

C/MIN(87)3(Final)  
Synthesis Report



Table 5

TRENDS IN OUTPUT STRUCTURE AND RESOURCE USE  
 Sectors Ranked by Openness to Foreign Competition  
 Average Annual Growth Rates for the Period 1970 to 1983

	NOR	BEL	DNK	FIN	SWE	FRA	GER	ITA	GBR	CAN	AUS	USA	JPN	EU5	NORDIC	TOTAL
Percentage Growth Rates of:																
VALUE ADDED (VOLUME)																
All sectors	3.03	2.55	2.30	3.48	1.99	2.99	2.30	2.28	1.15	3.21	2.73	2.59	4.66	2.29	2.51	2.82
of which:																
Gov&Soc	4.84	3.88	3.92	4.09	3.03	3.08	3.47	2.68	1.89	2.40	3.74	2.17	3.78	2.95	3.66	2.73
Shelter	3.26	2.03	1.23	3.75	2.04	3.26	2.52	1.94	1.86	4.09	2.93	2.93	4.84	2.49	2.38	3.10
Supply	2.17	1.20	2.90	1.30	0.76	0.97	0.21	1.59	-1.23	1.89	2.56	-0.83	1.30	0.62	1.55	0.43
Open	0.65	2.90	2.66	3.77	0.99	3.16	1.54	2.48	-0.06	2.30	1.15	2.91	6.07	1.83	1.85	2.96
TOTAL FACTOR PRODUCTIVITY																
All sectors	1.12	1.60	0.99	1.87	0.71	1.39	1.37	0.66	0.49	0.29	0.91	0.38	1.55	1.06	1.05	0.75
of which:																
Gov&Soc	1.28	0.86	0.13	0.56	-0.24	0.40	0.57	-1.21	0.87	-1.10	0.30	0.16	-0.87	0.13	0.18	-0.02
Shelter	1.02	0.75	0.19	1.86	0.86	1.06	1.23	0.50	-0.16	0.60	0.55	-0.18	1.25	0.69	0.89	0.36
Supply	3.15	2.93	3.89	2.37	1.98	2.12	2.17	2.42	0.91	0.72	2.70	-0.62	1.34	2.04	2.64	1.05
Open	0.16	3.72	2.83	2.36	1.01	2.49	1.82	1.98	1.33	0.83	1.43	2.03	3.91	1.95	1.53	2.22
CAPITAL STOCK																
All sectors	4.02	4.03	2.92	4.08	3.02	4.41	3.42	3.61	2.43	4.73	3.51	2.82	7.84	3.47	3.38	3.67
of which:																
Gov&Soc	4.48	3.49	2.63	3.52	2.63	4.26	4.25	5.28	1.79	4.29	2.90	2.27	8.96	3.86	3.09	3.51
Shelter	3.85	4.46	2.85	4.35	3.05	4.73	3.41	3.36	2.75	5.00	4.13	3.00	7.61	3.57	3.39	3.72
Supply	4.12	2.80	4.21	3.77	3.66	3.17	1.34	3.31	1.92	4.69	1.31	2.81	7.39	2.53	3.89	3.62
Open	4.21	3.48	3.15	3.96	3.20	4.10	2.75	2.65	2.31	4.36	2.28	3.60	7.02	2.92	3.50	3.83
EMPLOYMENT																
All sectors	0.74	-0.07	0.55	0.51	0.60	0.22	-0.44	0.43	-0.37	2.34	1.27	1.58	0.79	-0.07	0.59	0.83
of which:																
Gov&Soc	3.10	2.82	4.19	3.55	3.31	2.09	2.20	2.90	0.70	3.44	3.51	1.72	2.92	1.88	3.52	2.14
Shelter	1.05	0.10	-0.27	0.69	0.09	0.71	-0.10	0.82	0.96	2.85	1.45	2.57	1.82	0.57	0.30	1.68
Supply	-2.97	-3.34	-2.72	-3.05	-3.01	-2.97	-3.31	-2.51	-3.28	-0.22	-0.64	-0.85	-3.08	-2.97	-3.15	-2.49
Open	-0.95	-2.59	-1.44	0.55	-1.22	-0.77	-1.60	-0.32	-2.85	0.50	-1.13	-0.18	0.01	-1.53	-0.82	-0.70
Memorandum Item																
Labour force	2.04	0.75	1.24	1.25	0.86	0.79	0.22	0.82	0.42	2.89	1.80	2.32	1.03	0.54	1.23	1.37



Table 5 continued

	NOR	BEL	DNK	FIN	SWE	FRA	GER	ITA	GBR	CAN	AUS	USA	JPN	EU5	NORDIC
Difference between Actual and Calculated Growth Rates of:															
VALUE ADDED (VOLUME)															
Gov&Soc	2.02	1.49	1.83	0.48	1.42	0.20	1.20	-0.03	1.03	-0.50	0.73	-0.09	-1.20	0.61	1.46
Shelter	-0.10	-0.88	-1.29	-0.27	-0.24	-0.12	0.18	-0.26	0.34	0.32	-0.24	0.03	-0.03	-0.02	-0.47
Supply	1.59	1.28	2.73	-0.25	1.08	0.45	0.61	1.36	0.45	0.97	2.33	-0.70	-1.01	0.75	0.97
Open	-2.67	0.41	0.16	0.28	-1.36	-0.07	-1.13	-0.02	-1.40	-0.66	-1.09	0.13	1.32	-0.66	-0.89
TOTAL FACTOR PRODUCTIVITY															
Gov&Soc	1.04	-0.01	-0.22	-0.53	-0.19	-0.22	0.32	-0.92	1.19	-0.80	0.15	0.55	-1.78	0.01	-0.07
Shelter	0.27	-0.58	-0.42	0.44	0.69	0.11	0.63	0.32	-0.14	0.59	-0.08	-0.18	0.04	0.17	0.29
Supply	1.93	1.31	2.36	0.20	1.02	0.65	1.07	1.53	0.59	0.06	1.40	-1.18	-0.62	0.97	1.12
Open	-2.33	0.79	0.35	-0.47	-1.11	-0.36	-0.86	-0.11	-0.54	-0.57	-0.59	0.12	1.25	-0.49	-0.85
CAPITAL STOCK															
Gov&Soc	0.68	-0.47	0.02	-0.47	-0.13	-0.54	0.70	1.36	-1.38	-0.68	-0.48	-0.27	1.27	0.01	-0.01
Shelter	-0.29	0.27	-0.22	0.17	-0.06	0.35	-0.08	-0.34	0.44	0.33	0.50	-0.01	-0.43	0.11	-0.10
Supply	0.45	-0.48	1.47	0.04	1.11	-0.55	-1.50	0.10	0.40	0.43	-1.78	0.55	-0.04	-0.44	0.71
Open	0.30	-0.27	0.40	-0.11	0.04	-0.06	-0.45	-0.55	0.21	-0.30	-1.14	0.85	-0.73	-0.22	0.10
EMPLOYMENT															
Gov&Soc	1.05	1.63	2.44	1.38	1.61	0.53	1.06	0.59	-0.01	0.21	0.86	-0.69	0.26	0.55	1.68
Shelter	-0.42	-0.60	-1.63	-0.96	-1.19	-0.46	-0.60	-0.59	0.52	-0.27	-0.52	0.37	0.01	-0.28	-1.11
Supply	-0.50	-0.21	0.08	-0.74	-0.28	-0.12	0.02	-0.19	0.25	1.18	1.64	1.32	-0.79	-0.06	-0.42
Open	-0.47	-0.93	-0.63	0.96	-0.48	0.33	-0.11	0.42	-0.96	-0.09	-0.67	0.11	0.18	-0.15	-0.20

Notes: "Gov&Soc" = Producers of Government and Community services  
 "Shelter" = Market services  
 "Supply" = Sectors based primarily on natural resources  
 "Open" = Manufacturing minus primary metals (included in "Supply")

Source: Secretariat Estimates.



NOTES TO TABLES 4 AND 5

1. Method: The data presented in the Tables are normalised for differences in growth rates between countries and in OECD-wide growth rates between sectors. In other words, the data presented in the Tables represent the difference between the growth rate of a particular group of sectors in a country or grouping of countries and the growth rate that could have been expected, given that country's (or group of countries') overall growth rate and the growth rate of the sector (or group of sectors) on an OECD-wide basis (1). In this sense, the data reflect structural change in the composition of domestic output relative to world output, rather than being the actual growth rates of the sectors involved.
2. Data: Full details of the data sources and the exchange rates and price deflators used can be found in the Statistical Annex to the Introduction to the Technical Report. Briefly, the data are derived from national accounts sources and are all expressed at constant prices. Eighteen national accounts sectors are used and their ranking in terms of the aggregates is as follows:

Sector	Classified in Group High, Medium or Low by Growth of Output	Classified according to International Exposure
Agriculture	L	Supply
Electricity, gas and water	M	Shelter
Construction	L	Shelter
Wholesale and retail trade	H	Shelter
Transport	H	Shelter
Financial institutions	H	Shelter
Real estate	H	Shelter
Community services	H	Gov & Soc
Government services	M	Gov & Soc
Food and tobacco	M	Open
Textiles and clothing	L	Open
Wood products	L	Open
Paper and allied products	M	Open
Chemicals	M	Open
Glass and allied products	L	Open
Primary metals	L	Supply
Machinery and equipment	H	Open
Miscellaneous manufacturing	M	Open

1. The growth rates that could have been expected are calculated with the RAS method developed by R. Stone, Department of Applied Economics, Cambridge University, Input-Output Relationships, 1954-1966, Vol. 3, in: A Programme for Growth, Chapman and Hall, London, 1963.



## Notes to Tables 4 and 5 (continued)

Ranking by growth of output is done on an OECD-wide basis, with growth rate of value-added at constant prices over the period 1970-1983 being the ranking criterion.

As far as exposure to international competition is concerned, the sheltered sectors are the sector of Government services and community and social services (Gov & Soc) and the other service sectors (Shelter). The remaining sectors are divided in the sectors whose development is mostly affected by supply conditions (Supply) or which are most open to foreign competition (Open).

The European countries are grouped together: EU5 includes France, Germany, Italy, United Kingdom and Belgium, and Nordic covers Denmark, Norway, Sweden and Finland.



period -- compared more than favourably with outcomes elsewhere. In particular, Japan was distinguished by a highly efficient process of wage adjustment, as the organisation of unions on an enterprise basis and the competitive nature of wage setting in the largely non-unionised small-firm sector led to a closer and more rapid link between corporate profitability and collective bargaining outcomes than prevailed elsewhere. At the same time, there was intense competition between suppliers in the domestic market, which placed firms under continuing pressure to respond to changing technological and commercial opportunities -- a response greatly facilitated by high (and still rising) levels of education in the labour force, considerable labour mobility within large firms and between smaller firms, and the close links between the banking system and industry. Though expanding, the public sector remained far smaller in Japan than in other countries. As a consequence, levels and rates of taxation were significantly lower, notably on labour use; and this reduced the wedges between market prices and post-tax returns, facilitating the response to market signals.

68. The interaction of these factors resulted not only in very high relative growth rates (the Japanese capital stock, for example, growing at twice the OECD average), but also in large scale output redeployments. In particular, a marked transfer occurred from the non-traded to the traded goods sector, the normalised output shift being in the order of 2.2 per cent a year. This shift was paralleled by a transfer of output from the sectors growing less rapidly on an OECD-wide basis towards those expanding most rapidly.

69. These output shifts largely reflected the pattern of productivity advance in Japan. Thus, while total factor productivity in the Japanese traded goods sector was increasing at twice the OECD average, it remained virtually constant in the services sector, large parts of which (notably distribution and transport) were significantly affected by direct and indirect regulation. At the same time, productivity in the heavily-protected agricultural sector was growing far more slowly than in the rest of the OECD area. The traded goods sector was therefore becoming increasingly competitive, both relative to other domestic uses of resources and internationally; and this contributed to the rising dependence of the



Japanese economy on the growth of external markets and of Japanese shares in them, in a trend aggravated in the first half of the 1980s by the over-valuation of the dollar and the associated under-valuation of the yen.

70. As in Japan, wage adjustment in the United States occurred relatively rapidly, though at the expense of very large (but short-lived) increases in unemployment rates. The factors underlying wage adjustment were also in certain respects similar to those in Japan: the decentralisation of collective bargaining to the enterprise level and the strength of competition between the union and non-union parts of the economy, the non-union sectors adjusting more rapidly. At the same time, the response of firms and industries to emerging opportunities was facilitated by the continental scale of the United States market and the favourable effects market size had on the intensity of competition; by an abundant supply of highly trained scientific and technological personnel; by the speed with which skills and knowhow diffused through the United States economy; and by the diversity and sophistication of the financial system.

71. As a result, a rapidly growing labour force was absorbed into employment. Shifts in output between activities were not as great as in a number of other countries, owing in part to the size and diversity of the U.S. economy and to the relatively small share of foreign trade in U.S. economic activity, as well as to the blunting effects of protection in the industries -- such as steel and automobiles -- where United States competitiveness had declined most severely. But considerable adjustment occurred within (rather than between) sectors, as in many industries new competitors appeared who faced lower wage costs than established firms, often thanks to a shift in location. While employment growth was strong, it combined with relatively small flows of savings into productive investment and a shift of activity to sectors with slow productivity growth, thereby leading to extremely low growth rates of productivity overall -- indeed, among the lowest in the OECD area. Given the low ratio of trade to output, the consequent loss of competitiveness was only felt with a considerable lag; but the growth of living standards faltered and, indeed, was kept from slipping further only by a continued decline of household saving and, recently, by extensive foreign borrowing.



72. The Nordic countries illustrate an adjustment process in which wages were sensitive to external competitiveness and to changing internal circumstances, though the extent of adjustment was perhaps not as complete as in the United States and Japan. However, the forces underlying wage adjustment were quite different. In particular, during much of the 1970s, the centralisation of collective bargaining played an important role by encouraging wage-setters to take a broad view of their functions and responsibilities and by forcing them to bear the macroeconomic consequences of their actions in mind; and wage outcomes reflected a strongly-held attachment to solidaristic principles and to full employment.

73. A willingness to adjust in labour and product markets appears to have been to some extent predicated on government commitments to support incomes through transfers and through direct employment, as well as through government labour market schemes. Consequently, while high levels of employment were maintained, as were reasonable rates of output growth, much of the growth in output and virtually all of the growth in employment occurred in the public sector, with value-added in government expanding at a rate 30 per cent above that for the countries combined. In contrast, growth rates in the activities exposed to international competition fell significantly behind those in other countries, as did growth rates in the activities which were expanding most rapidly on an OECD-wide basis. These shifts in structure entailed moving output and resources from activities with above-average rates of productivity growth to those whose productivity performance was distinctly poorer -- a shift which clearly could not be maintained over the longer term without compromising the rise in living standards. These strains and others have resulted in an erosion of the solidaristic foundations and macroeconomic responsiveness of centralised bargaining, as increasingly divisive conflicts have emerged between public and private sector employees, reflecting broader difficulties in operating economies with a very large non-market sector.

74. Finally, among a number of other European countries, the difficulties of adjustment were most visible in rising unemployment -- especially but not only in the United Kingdom, France, Italy and Spain. These imbalances reflected persistent problems of the industrial relations system in securing reasonable wage outcomes, averting industrial conflict, and achieving and



maintaining efficient work practices. Aggregate wages tended to depart from a course consistent with the evolution of real national incomes, placing considerable pressure on profit shares -- even in the face of extremely high unemployment. On average, over the two decades to the mid-1980s, a 1 per cent increase in the unemployment rate reduced semiannual nominal wage growth by 1.66 per cent in Japan and by 0.60 per cent in the United States; though the figure for Italy was comparable to that for the United States, the moderating effect of unemployment on wage demands was only 0.33 per cent in France, 0.23 per cent in Spain and 0.15 per cent in the United Kingdom -- that is, each percentage point increase in unemployment had a moderating effect on wage settlements five times greater in Japan than in these European countries. The effects of wage trends on employment levels were compounded first, by pervasive regulatory action in labour markets (notably through minimum wage legislation and restrictions on hiring and firing); and second, through distortions to the relative wage structure which priced those with few skills out of jobs and aggravated labour market segmentation.

75. Paralleling these rigidities in labour markets were industry structures long used to an environment in which competition had been restricted by various means; and firms were hindered in their response to change by lagging education and training of the labour force and by an excessive concentration of technological skills in activities working mainly or solely for government. As adjustment pressures mounted, firms and industries in difficulty often succeeded in obtaining extensive subsidies and trade protection -- reducing even further the incentives to adjust. At the same time, public sector expenditure was rising rapidly, and this was reflected in a sharp increase in average and marginal tax rates, and notably in the taxation of labour markets.

76. Together, these trends contributed to the rise of unemployment, particularly among the young; but also to important shifts in the pattern of resource allocation. In particular, the only sectors to substantially increase their share in resource use (and especially of capital inputs) were the sheltered sectors and the energy sector (expanding rapidly in the United Kingdom). At the same time, there was a decline in the share of manufacturing that was most exposed to international competition, as well as in that of the sectors growing most rapidly on an area-wide basis.



77. In essence, though the strains bearing on the various countries were broadly similar, the national responses centred on differing adjustment mechanisms; but the process was in no case ideal and in each case tended to postpone an important feature of the problems to the future. Thus, Japan could not indefinitely continue to rely on a demand dynamism driven by exports in order to sustain growth above that of the rest of the world; the United States could not continue to increase or even maintain living standards through low domestic savings and borrowing from abroad; the Nordic countries could not continue to rely on the expansion of the government sector to provide increased jobs and output; and among the larger European countries, inefficiencies arising from factor and product markets, as well as from the growth of the public sector, were leading to significant losses of income and higher rates of unemployment. Other OECD countries too faced unresolved adjustment problems that combined these features in different ways.

78. The results of these accumulated imbalances are now emerging: in exchange rate movements which entail sharp shifts in competitiveness; in tighter constraints on the extent to which the public sector can ease the difficulties of individual firms and workers; in mounting concern about the persistence of unemployment. Resolving these imbalances will place yet greater burdens on the adaptability of national economies; and much will depend on the efficiency with which firms and workers respond to relative price changes, domestically and internationally. Enhancing the capabilities to respond and strengthening the incentives for needed adjustments to occur are therefore urgent tasks -- both to ease the immediate problems of economic policy and to place economic growth on a surer footing.

## II. STRUCTURAL POLICIES: A PROGRAMME FOR CHANGE

79. Many countries have, in recent years, sought systematically to review microeconomic policies and reduce distortions to the functioning of markets. Yet the progress to date is uneven; and if the prospects for growth are to be durably improved, further action is needed.



80. This action is best seen in terms of a strategy or a programme -- a connected set of measures for easing the constraints which impeded better performance in recent years, and for obtaining greater flexibility in the economy as a whole. By achieving a consistent thrust of reform across a wide range of areas, such a programme would be designed to secure the greatest gains from progress on a broad front; it must centre on action to increase competition in product markets, to strengthen the responsiveness of factor markets, and to secure increased efficiency and effectiveness in the public sector.

A. Increasing competition in product markets

81. Competition in product markets not only stimulates an efficient use of existing resources but is essential for rational investment decisions and provides incentives for the development of new products and processes. Yet the full benefits of product market competition will not be reaped without an extensive reassessment of current policies.

1. Agriculture

82. The agricultural policies pursued by the OECD countries over the last three decades are unsustainable. By maintaining returns to farmers at levels inconsistent with market balance, they have encouraged enormous overproduction, forcing prices down on the relatively narrow markets open to international competition while accentuating protectionist pressures on others. Yet the policies have hardly met their stated goals: the subsidies they provide have largely been capitalised into land values and almost everywhere have overwhelmingly gone to the largest producers; by increasing the intensity and intermediate input usage of farming they have created a range of environmental concerns; and far from stabilising the sector, they have encouraged over-capitalisation and increased vulnerability to market shocks. A growing number of countries have attained food self-sufficiency, but the economic cost has been high -- estimates suggesting that current agricultural policies reduce OECD GNP by as much as 1 percentage point.



83. There is no economic reason for sheltering agriculture as a whole from the operation of market forces. Far from being an inflexible sector, incapable of responding to changing market trends, modern farming has demonstrated an extraordinary facility to adjust to the incentives of prices and returns. Moreover, it is likely that in a liberalised agricultural market, financial institutions would -- in this area as in others -- prove resourceful in finding ways of spreading and easing the risks that the sector is often thought to face.

84. A transition to a more market-oriented agriculture is therefore desirable -- and indeed many would view it as unavoidable, if the sector is not to collapse under the weight of its own surpluses. The key in this respect is the fundamental reform of domestic agricultural policies; for it is these policies which are responsible for the present disarray in world food markets. The aim must be to increase the role of international market signals in the sector's decision-making; and this requires price adjustments so as to reduce the incentives which current support levels give for overproduction and to bring prices on major markets into line with those prevailing on the markets open to international competition.

85. At least in the high income countries, it is unlikely that price reductions would lead to a further significant decline in sectoral employment; rather, they would affect primarily the sector's demand for non-labour inputs. But though it would not necessarily reduce employment, a transition to more competitive agricultural markets would erode the gains larger farms now make from price supports and, most importantly from a social and political point of view, could reduce the often low incomes of smaller producers. It is a matter of judgement and political circumstance whether compensation for these effects is considered desirable or indeed feasible.

86. There may nonetheless be a case for providing continuing income support to poorer farmers, or for farming in environmentally or strategically significant areas. If the political will can be found to confine income support to marginal farms, the impact of such support on total agricultural output -- and hence on market distortions -- is likely to be minimal. However, any policy on these lines will need to be formulated bearing in mind



that in the past many of the policies which have proved so unsustainable have been advocated in the name of the marginal farmer. All of this suggests that the policies adopted should as far as possible "decouple" the provision of income support from production incentives, so that attempts to ease the transition difficulties reform will undoubtedly create do not unnecessarily impede the sector's return to market balance.

87. In the lower-income OECD countries, the price reductions needed to achieve market balance could have the most serious effects for large numbers of producers. This would create economic, social and political problems which straightforward income support payments might not entirely resolve. For these countries it will be necessary to find appropriate policies that will enable the necessary adjustment to be achieved without serious repercussions on the social fabric in their rural areas.

88. The tensions arising from the accumulation of surplus stocks and the widespread recourse to dumping on third markets need to be reduced in a shorter time-frame than that required for the fundamental reform of agricultural policies. Yet it is essential that the measures taken should neither preclude nor prejudice the sector's longer term move to a more sustainable policy setting; but this can hardly occur if markets are further disrupted. A gradual and disciplined reduction in current excess stocks, accompanied by intensified price adjustments, notably in the markets where levels of trade distorting assistance are now highest, would provide the most favourable conditions for initiating the indispensable process of reform.

## 2. Industrial adjustment

89. As growth slowed and unemployment mounted, governments came under intense pressure to ease the strain of adjustment both in certain mature industrial sectors -- such as textiles, shipbuilding and steel -- as well as in sectors which were highly energy-intensive -- notably basic chemicals, non-ferrous metals and transport. The difficulties of these sectors were compounded by changes in international competitiveness, and especially by the steady rise in the Newly Industrialising Countries' share of world markets. And they became even more severe with the shift to less accommodating macroeconomic policies following the second oil shock.



90. In fact, assistance to firms and industries in difficulty comprised a large and -- until the early 1980s -- rapidly growing part of governments' industrial policy efforts. However, the instruments used varied significantly from country to country, as did the results obtained.

91. In Europe, policies for industries in difficulty have centred on financial assistance, frequently provided on a targeted basis to individual firms. The subsidies thus provided accounted for much of the rise in government transfers to industry over the period from the early 1970s to the mid-1980s; at constant prices, these more than trebled in France and Italy, doubled in Germany and increased significantly in a number of other countries. In Japan, direct financial transfers have not been a major instrument of government policy; industries in difficulty have been encouraged to reduce capacity rapidly within the context of "concerted actions" which have frequently benefitted from derogations to competition policy. In the United States, subsidies have remained very limited; but several of the sectors facing the most acute adjustment problems have been granted trade protection which, once accorded, has tended to be perpetuated.

92. At the same time, a number of governments, faced with the inevitable decline of sectors which had traditionally been major employers, have sought to promote new, more promising areas of activity, frequently in industries associated with "high technology". The level of financial assistance provided is difficult to quantify; but to take only one indicator, public funding of R&D for industrial development doubled in real terms over the period 1973-85.

93. Experience highlights the limits of these policies. Subsidies to firms and industries in difficulty have kept capacity no longer viable in operation; and they have hindered industrial adjustment by confusing the signals which influence corporate decision-making:

- Inconsistencies between policy objectives (for example, rationalisation and the maintenance of employment) have led firms into unsustainable strategic options;



- The availability of government subsidies has made it difficult to obtain labour force approval of painful but ultimately indispensable changes in employment levels and working practices;
- Subsidisation has distorted competition between favoured firms and sectors on the one hand and less politically influential players on the other.

94. Severe constraints also bear on policies aimed at promoting new, "high-technology" activities. The results have frequently been disappointing -- and especially so of policies which have sought to replace market signals and "create" comparative advantage in a broad range of sectors considered strategic. These policies, especially widespread in Europe, have exercised their major influence in sectors dominated by public procurement. But even when they have achieved their proximate technological goal, they have frequently led to an excessive concentration of technical capabilities in activities geared to the public sector, thus adversely affecting the competitiveness of other industries.

95. Overall, the ease or difficulty with which manufacturing industry in different countries has responded to changing opportunities and constraints has depended less than is often thought on specific industrial policies and more on the characteristics of each country's market environment -- on the extent of rivalry between firms and the pressure of competition; the efficiency of capital markets in identifying new activities and sustaining restructuring in old; the flexibility of labour markets not only in terms of the mobility of labour but of the responsiveness to evolving needs for skills; and the effectiveness of the links between firms and the research system -- notably that of the universities -- in guiding the allocation of research efforts and promoting the diffusion of their results.

96. The experience of the United States, Japan and Germany confirms the crucial role of competitive forces and of the environment in which industry operates not only in ensuring rationalisation of sectors in difficulty but also in promoting speedy adjustment to technological opportunity. Firms in each of these countries have proved particularly successful in exploiting the



potential for innovation, be it in entirely new activities or in more traditional ones; and this is linked to a number of common features in the stance governments in these countries have taken, though individual policies have of course differed.

97. In each case, the policies have departed from what might have been desirable: in Japan, the policy process has been such as to generate persistent charges of discrimination against foreign firms; in the United States, the large scale transfers provided through defence-related R&D may have "crowded out" civilian innovation efforts; and German policy did not entirely escape the temptation to rely on "national champions" for technological projects considered of particular significance. Yet governments in these three countries have been especially reticent to act as entrepreneurs; and in a context of intense competition on the domestic market, firms have taken primary responsibility for maintaining traditional areas of strength and/or developing new ones. Their efforts in this respect have been sustained by the depth and breadth of national education and training systems and by the efficient functioning of factor and product markets.

98. By the mid-1980s, governments were to some extent withdrawing from policies of selective subsidy, notably of firms and industries in difficulty -- even in the countries where assistance had previously been provided on the greatest scale. At the same time, though to a lesser extent, policies of support for activities considered promising were being reviewed; and horizontal measures, aimed at promoting a broadly-based capacity for developing and diffusing technology, gained importance relative to assistance more narrowly aimed. But to a considerable degree, the shift has reflected concerns about policies' budgetary costs as much as their economic consequences; and in many countries, there has been a strong tendency to at least partially replace visible, on-budget support with the less transparent but no less real subsidies provided by trade protection.

99. Looking to the future, the objectives, instruments and methods of implementation of industry policies will continue to reflect the specific requirements of each national context. However, experience shows that all the



policies that have proved effective have a number of features in common, and that, conversely, there are certain features that make it likely that policies will fail in any national environment.

100. In particular, the outcomes of industrial policies have frequently been disappointing because the goals set were too broad and the priorities too diluted; and because the policies themselves were inconsistent with government action in other areas. The costs imposed by these more general weaknesses have been compounded when policies have sought to go against the fundamental course of comparative advantage; have provided assistance on a basis which, in practice, is open-ended, despite initial intentions for its progressive phasing-out; have failed to assess carefully the displacement effects which assistance granted to any particular firm or sector has on others; and have been subject to little effective monitoring of outcomes against intentions.

101. Overall, the changes that have taken place in industry and in its environment -- lower overall economic growth, increased uncertainty in the monetary and energy fields, converging patterns of national consumption, internationalisation of production and trade, technological advance -- create conditions for government action that are radically different from those under which the broad principles and instruments of industrial policy were devised in the 1950s and 60s. These conditions make narrowly targeted, selective measures increasingly less effective; and they heighten the importance of securing a swift and adequate response from private agents to market pressures. Whether such a response is forthcoming depends first and foremost on the environment in which firms in each country operate; and it is through action to improve this environment that policies can best promote the adjustment of firms to technological advance, as well as to changing patterns of supply and demand more generally.

102. Policies in a broad range of areas are relevant -- including competition policy, education and training, the regulation of capital markets and of course international trade; but action to strengthen research capabilities in the advanced economies, and to encourage their more efficient use, have a particularly close bearing on industry's capacity to create and exploit opportunity.



103. Much of the research effort of the OECD economies is oriented to immediate needs, in particular to the development of new products and processes. The funding and performance of applied research and development is primarily a responsibility of industry -- and the evidence suggests that the private and social returns on applied R&D are often greatest when it is left in industry's hands. Yet there is also a significant component of research which is more long-term in its orientation -- which aims not at particular commercial outcomes but at advancing understanding of basic scientific properties; and though less easily quantifiable, the economic importance of this type of research is no less real. In numerous areas of current technical advances -- for example, microelectronics and biotechnology -- the boundaries between basic and applied research have blurred; and, the accelerating pace and changing nature of science and technology confer on some applied research and most basic research a renewed strategic character, making it all the more important that future developments and their efficient exploitation be based upon and nourished by a continuing influx of new fundamental knowledge. The adequacy of the basic research system is consequently of increasing significance to economies' capacity to create and exploit scientific advance.

104. Governments have an acknowledged responsibility for funding basic research -- and indeed they carry the main burden of doing so. But particularly in Europe, the combined effect of changing government priorities and rising costs for research has been to place increasing pressures on the basic research system, and notably on the universities. In fact, universities in the OECD area (with the noticeable exceptions of Japan and the United States) have undergone a gradual erosion of their ability to carry out research using up-to-date equipment and of their capacity to renew their skill base, reflected in an ageing scientific workforce. In their search for new sources of income, universities have turned to external financial support; though desirable in many respects, this has resulted in a general shift away from basic research towards more visible, shorter-term oriented research. In Europe, it did not prevent a real decline over the period 1975-83 in the average resources available per university researcher, a decline only partially reversed in subsequent years.



105. The extent of the difficulties has differed from country to country; and it has proven especially difficult to reallocate resources among competing projects and institutions in countries where government laboratories account for a large share of all resource use in basic research. This is especially so in Europe and Australia, where government laboratories account for as much as half of all government expenditure on R&D; and these laboratories have generally succeeded in protecting (and in several cases actually increasing) their funding while that of universities was being cut (Table 6, p.48).

106. Securing greater flexibility in the research system, while maintaining a commitment to the highest quality levels, requires improvements both in the institutional framework and in resource allocation mechanisms -- in particular, a review of the role of government laboratories as centres for long-term research; a move towards employment contracts which favour labour mobility; more systematic appraisal of research performance, not only on an ex ante basis but also ex post; and the encouragement of links with industry. International cooperation in basic research can also make a significant contribution to increasing the efficiency of the science system, by allowing countries to share the high costs of advanced facilities and ensuring the rapid international diffusion of research results.

107. Ultimately, whether firms respond to the opportunities arising from technological advance, as well as to broader changes in economic circumstances, depends largely on the intensity of competition -- and on the incentives this creates for the firms which successfully adjust, and the penalties for those which do not. Competition policy has an essential role to play in strengthening these incentives and penalties, domestically and internationally.

108. A clearly set-out legal framework, which establishes a presumption in favour of market rivalry and of the development of new and more efficient sources of supply, contributes to economic and social pluralism and encourages firms to concentrate on achieving greater competitiveness, rather than to dissipate resources in creating artificial barriers to new competition. Moreover, an active competition policy can provide an efficient means of achieving public objectives -- and notably that of securing reliable and



Table 6

LEVEL AND CHANGES IN R&D RESOURCES PER RESEARCHER, 1983  
in 1 000 \$ and index, constant prices(1975 = 100)

	Business Enterprises		Higher education		Government		All sectors	
	Level (\$1 000)	Index	Level (\$1 000)	Index	Level (\$1 000)	Index	Level (\$1 000)	Index
United States	119	102	118	100	179	114	123	102
Japan (1)	87	131	40	118	103	131	70	130
EEC (2)	155	105	57	82	133	99	116	98
Other (2)	146	104	74	108	107	108	119	106
Total (2)	119	106	66	99	141	109	106	105

1. Official data. Adjusted to OECD standards, R&D expenditures per researcher would read as follows:  
\$118 000 per researcher in the higher education sector;  
\$130 000 per researcher for all sectors.
2. EEC: excluding the United Kingdom and Greece; Other: excluding New Zealand, Turkey, and Yugoslavia.

Source: Secretariat estimates.

cost-effective service -- in areas which have traditionally been subject to more direct and constraining forms of government intervention, for example, through regulation. In all of these ways, the legal framework for competition policy can increase the efficiency of market outcomes -- making direct government involvement all the less necessary.

109. Fulfilling these functions requires that competition policies adapt to changing circumstances. It is increasingly recognised that many forms of corporate behaviour once thought unacceptable are rational and indeed desirable responses by firms to opportunities for achieving greater efficiency through horizontal and vertical cooperation. Nonetheless, these responses can create risks for the open functioning of markets -- as mergers and cooperation between firms may facilitate collusion, concentrate resources and increase the difficulties a new supplier would have to face. Whether these risks are worth



bearing depends to a very great extent on other aspects of policy -- and first and foremost on the effective degree of exposure to international competition. In the long run, policy against restrictive business practices, however vigorous it may be, can do little to promote efficiency in an economy where firms benefit from government interventions which shield them from market realities, domestically and internationally.

### 3. International Trade

110. The single most effective means of securing responsiveness to changing opportunities is through exposure to international trade. The efficiency gains of trade are most visible in product markets: they are the gains which come from access to markets world-wide, from the diversity and variety of goods which only markets on this scale can provide, and from the constant contact with, and pressure to adapt to, new ways of doing things. But openness to international trade is also important in reshaping factor markets -- and notably in ensuring that collective bargaining is exposed to market signals which can clearly indicate when outcomes are unsustainable and which can help in guiding bargainers to better solutions. For all of these reasons liberal trade is more than a means of reallocating economic resources -- rather, it is the key to securing the consumer interest in an efficient and high-income economy, providing all goods and services on the best terms.

111. Looking to the future, the scope for improving living standards through international trade is, if anything, likely to increase. At a regional level, there remain large unexploited gains from economic integration -- and recent estimates suggest that the gains from achieving a degree of economic integration in Europe equal to that of the United States could be as great as 10 per cent of European GDP, though its effects on non-European countries would also have to be taken into account. The continuing industrialisation of the developing economies also creates new markets for OECD exports -- and new sources of supply in a broad range of industries. At the same time, the efficient use of new product and process technologies evidently depends heavily on access to large markets. And in areas such as data processing, new technologies are making an increasing range of services tradeable, with the gains from trade in these likely to be no smaller than those reaped in manufacturing.



112. Action to strengthen and extend the open, multilateral trading system -- both by the OECD countries and by the developing countries -- is the key to securing those gains; yet even within manufacturing, where the gains from liberalisation have been greatest, a considerable erosion of liberal trade has occurred in recent years. This erosion should be reversed as a matter of urgency.

113. It is of primary importance to dismantle the protectionist measures which -- having been put in place to ease immediate sectoral problems -- have become an enduring feature of the industrial landscape. The Multi-Fibre Arrangement (MFA), and the different trade restrictions with which it is associated, stand out. When the current Arrangement expires, fully thirty years will have passed since the first derogations of textiles trade from the ordinary discipline of the GATT -- derogations which were intended to be strictly temporary. But prolonged exemptions from liberal trade have also become a feature of other industries, notably steel and automobiles; and more recently, discriminatory measures have spread from industries in serious difficulty to sectors such as semiconductors which have high growth rates and excellent prospects. The net effect has been to severely undermine the principle of non-discrimination, eroding the MFN clause which underpins open trade.

114. Even removing these measures will not suffice to restore the confidence of traders and investors that reductions in cost and improvements in quality will be rewarded through increases in world market share. This will require an assurance of greater discipline by all trading partners in their future behaviour, including progress as regards forms of protection which at present escape international obligations. The objective of granting foreign competitors a treatment no less favourable than that accorded domestic producers should remain paramount; the manner in which safeguard options in world trade are implemented is of utmost importance in this respect, as is the use more generally made of administrative protection and of anti-dumping action.

115. However, the need to strengthen the open trading system goes beyond the system's traditional manufacturing focus. Most immediately, the distortions



currently affecting agricultural trade not only impose significant economic costs -- they breed tensions which threaten open trade as a whole. Though these distortions are largely the products of domestic agricultural policies, a multilateral and multi-commodity approach to improving agricultural markets can play an important role in easing and sustaining the process of change.

116. This is firstly because an international approach to the problems of the agricultural sector has important economic advantages. Compared with unilateral liberalisation, a coordinated and multilateral approach would almost certainly lead to a smaller reduction in domestic prices in the more highly protected markets. The expansion of world trade induced by a coordinated strategy would reduce the adjustment problems; while the multicommodity nature of the approach would ensure that reduced assistance to one set of products does not compound market problems in others. The overall result would be a firming of prices on world markets, so that the overall shock to the sector would be smaller than a static comparison of current support prices and world prices suggests.

117. Multilateral trade agreements would also facilitate the political process of agricultural policy reform. The experience of three decades of trade liberalisation shows that these agreements, once entered into, are generally implemented -- mainly because they create powerful coalitions between the domestic interests which gain from the opportunities trade liberalisation creates, while the balance of advantages they provide to countries gives them substantial public legitimacy. By committing themselves to such agreements, governments can lend credibility to domestic policy changes which will be phased in only over a period of several years.

118. Finally, the full benefits of interdependence will not be secured if the world trade regime is not brought into line with the changing character of trade flows. Three areas stand out in this respect. First, the albeit slow increase in the share of science-based products in world trade creates new challenges to trade policy -- challenges associated with the importance which technical norms and standards and the protection of intellectual property have in encouraging the rapid diffusion of goods based on new technologies. Second, it is becoming clear that there is great scope for specialisation in



services: for example, in telecommunications, where new technologies are broadening the range and diversity of services which can be provided; but exploiting these gains will require an important extension of multilateral trade liberalisation. Third, trade and foreign investment have long been complementary elements of international economic interdependence; and their complementarity may be becoming tighter as high-technology goods and services -- which require extensive marketing and support -- become of greater significance. Ensuring an open international environment for foreign investment is consequently an important component of a strategy for sustaining the trading system.

119. The new GATT Round provides an essential opportunity to meet these challenges. The outlook for small and large economies alike now depends on access to global markets, access which enhances both microeconomic efficiency and macroeconomic responsiveness. Rapid and sustained progress in a new round of multilateral trade liberalisation would yield immediate economic benefits -- and the benefits would become all the greater as firms could with increased confidence plan on open markets in future.

#### B. Improving the responsiveness of factor markets

120. Combined, these measures would preserve and strengthen the role of product markets, domestically and internationally, as the engines of structural change. But adjusting efficiently to the incentives and signals coming from product markets requires a capacity to redeploy resources: to move labour and investment towards new opportunities -- and to ensure that they are used effectively where they are employed. This capacity hinges on the efficiency of factor markets. Here, too, there is important scope for policy reform.

##### 1. Financial markets

121. By allocating the economy's savings among competing investment projects, and monitoring the effectiveness with which these resources are used, capital markets have a major role to play in securing microeconomic efficiency and enhancing macroeconomic outcomes. Developments in OECD



## CONFIDENTIAL

- 53 -

C/MIN(87)3(Final)  
Synthesis Report

financial markets over the last decade have made it considerably easier for the financial system to exercise this role. The liberalisation and integration of capital markets, nationally and internationally, as well as greater competition among financial institutions, have led to better resource allocation decisions and strengthened the mechanisms for monitoring efficient resource use.

122. Significant advances have been made in financing industrial enterprises, with numerous new credit instruments complementing traditional types of borrowing and equity issues. Funding via negotiable instruments, in particular, has made considerable headway. This has permitted a broader spreading of industrial risks, increased firms' access to large-scale capital markets, and narrowed the capital cost differentials which the fragmentation of financial markets previously engendered -- in particular at the international level. Though the major initial beneficiaries of these advances were the largest manufacturing and service companies, they are now becoming widely available throughout the industrial system; and in a number of countries, actual or potential constraints on the availability of bank lending to small and medium-sized enterprises have largely disappeared as competition has increased in domestic markets.

123. The development of the venture capital industry, and the expansion of unlisted and third-tier stock markets, have assisted new business start-ups, especially in the high technology and high-growth service sectors -- with considerable longer term consequences in terms of generating jobs and incomes. Here too internationalisation has contributed to efficiency by encouraging the diffusion of venture capital skills and investment from a relatively narrow base to a far broader group of countries.

124. Lastly, developments in financial markets have facilitated the restructuring of corporate assets and portfolios, the introduction of new management teams, and the funding of large-scale projects. More diversified sources of funds for these operations have become available, with management buy-outs being of particular importance in durably improving the situation and prospects of many firms in decline or on the verge of bankruptcy.

CONFIDENTIAL



125. Nonetheless, the process of learning and experimentation inherent in these developments has brought in its train problems and concerns, as investors and borrowers take on new risks. Undoubted though these risks may be, they are a natural component of dynamic economies and are manageable so long as they are being taken with foreknowledge and with an adequate backing in terms of investors' capital. Moreover, certain of the new financial instruments themselves contribute to a more balanced risk spread, domestically and internationally. Seen over the longer term, an increased willingness of investors to bear risk, and an increased capacity of financial systems to diversify it and fund large-scale and/or high-risk projects, can only enhance economic efficiency.

126. Nonetheless, there may be concern that at present, the ultimate structure and distribution of risk -- domestically and internationally -- and the extent of its systemic effects are poorly understood and monitored. Prudential supervision policies need to be reviewed to provide better information about the nature and spread of these risks, to see that they are well understood by those who bear them and to ensure that their distribution poses the least threat to the integrity of the financial system.

127. Similar prudential principles should apply to the extent possible to all financial enterprises, without sharpening the statutory differences that traditionally distinguished various types of institutions -- and limited competition among them. A transition from supervision based largely on institutions to one based mainly on functions is a significant factor in policies to enhance competition on a "level playing field" in financial markets.

128. The reform of prudential policies also has an important international dimension. In an increasingly globalised financial system, safeguards cannot adequately be provided without reinforced international cooperation on prudential matters. At the same time, persistent differences between countries in prudential arrangements can only impede the international openness of financial systems, and distort competition between financial institutions. In this market as in others, integration provides gains in promoting innovation and cost-effectiveness; this makes the efforts now under way in a number of international fora, including the OECD, all the more significant.



## 2. Labour markets and collective bargaining

129. Labour markets serve a broad range of economic and social functions, as do the mechanisms through which employers and employees regulate their relationships. These functions reflect a mix of distinct but interrelated objectives: the search for a balance between wage levels and capacity to pay, which is an indispensable basis for maintaining high levels of employment; the need to obtain sufficient flexibility in labour allocation to be able to shift human resources towards the activities with greatest promise; the widely held aspiration for stability and security in employment, and the recognition that longer-term employment relations may contribute to the development and effective use of skills; and last but by no means least, the desire by employees to "have a say" in setting and implementing the conditions of employment and work.

130. These objectives are not always mutually consistent; both the institutions through which they are pursued and the emphasis they are given in different countries reflect a wide range of economic, social and political factors, many of them rooted in national history and aspirations. As a result, the process of institutional change is particularly complex, constrained, and in some respects, controversial. Yet it must also be recognised that in some countries, notably in Europe, improvements in the way labour market institutions function is essential if unemployment is to return to, and remain at, socially acceptable levels -- and if the institutions themselves are to retain their social legitimacy and broader role.

131. This is not to deny that considerable progress has been made in correcting the wage-profit imbalances (or "wage gaps") which had opened up at the end of the 1960s and continued to widen in the 1970s, as well as in reversing the excessive narrowing of wage differentials which had also occurred in that period. Yet the extent of the improvement, notably in Europe, should not be over-estimated. Though the wage gaps have been reduced, this has generally been obtained at an extremely high cost in terms of unemployment; and in the countries where the problems have been greatest, there is little evidence that the underlying pattern of wage formation has changed -- so that another adverse external shock would very probably create



yet further substantial joblessness. Every post-war recovery has come to an end because of the accumulation of inflationary pressures; and though the dangers appear more remote in present circumstances, the persistence of imbalances in labour market functioning cannot but increase the risks bearing on economic policy-making -- and make a more expansionary course all the more difficult to justify and implement.

132. A durable improvement in the wage setting process hinges on the evolution of labour market institutions and in particular, of collective bargaining. Given the range of objectives pursued in labour markets, and the distinct national features of labour markets and of the contexts in which they operate, it is extremely difficult to draw international lessons in this respect; but two quite different approaches to structuring the process of collective bargaining appear to have proved reasonably successful in obtaining economically sensible wage outcomes.

133. The first involves negotiations which are relatively highly decentralised. In Japan, the enterprise structure of unionism, combined with factors which strengthen the association between employees and their firms, ensure that wage settlements in larger enterprises adjust relatively speedily to companies' changing circumstances -- though this occurs in a context of relatively effective national coordination of pay bargaining, notably among employers. Wage adjustment is buttressed by a sizeable non-union sector, largely among smaller enterprises, which is probably most responsive to labour market conditions. In the United States, unions are mainly organised on an industry basis; but collective bargaining generally occurs at the enterprise level and is greatly affected by competition between a unionised and non-unionised sector. The unionised sector has tended to adjust only slowly (not only in terms of wages but also of working practices) and over the long term to shrink, so that market forces play an increasingly direct role in pay determination.

134. A second pattern, typical of the Nordic countries, but also found in Austria and (though to a much lesser extent) Germany, involves a relatively centralised system of wage-setting, hinging on a relatively small number of agreements with broad coverage. It also involves a sharp separation between



areas of the employment relations which are subject to negotiation between unions and employers -- most notably wages -- and other areas which though they may be subject to consultation are dealt with on a basis which is not generally adversarial. By and large, these systems have proved successful in setting aggregate wages because they confront wage bargainers with the macroeconomic consequences of their actions, thus overcoming some of the "prisoner's dilemma" features inherent in the adjustment of nominal wage demands to changes in economic circumstances. At the same time, the distinction between negotiation and consultation has made it easier for good work practices to be maintained and has encouraged harmonious relations at the place of work. Outcomes in both these respects have also been tempered by a high level of exposure to international competition -- and by a recognition that failure to adjust can only increase the costs which must be borne.

135. However, labour market outcomes have been consistently poorer in those countries -- notably the United Kingdom, France, Italy and Belgium -- where collective bargaining structures fall between these extremes: where outcomes have been neither subject to the direct constraints of decentralised bargaining and competition in labour markets, nor guided by a wider recognition of economic and social responsibility; where the setting of wages and of the conditions of employment has typically functioned through a multiplicity of overlapping and competing levels, fragmenting employer solidarity and encouraging inflationary spirals of bargaining around long established pay relativities; and where the legal framework for bargaining has been poorly spelt out in terms of the rights and duties of the parties to collective agreements.

136. There are no easy solutions to these problems. But bargaining structures in these countries are unlikely to evolve towards highly centralised structures -- and indeed, centralisation itself seems to be under great pressure even in the Nordic countries where it has prevailed for many years. Rather, a greater degree of decentralisation of collective bargaining to the enterprise level appears to be the most likely outcome and corresponds to a broad OECD-wide trend.



137. However, decentralisation is not a panacea and indeed, in economies with high levels of unionisation, it may aggravate inflationary pressures. To lead to sustainable wage outcomes it needs to occur within a legal framework which establishes the contractual status of collective agreements and facilitates the resolution of disputes. It must also be underpinned by a recognition of the role which competition plays in steering collective bargaining towards sustainable solutions. This is first and foremost a question of competition in product markets -- notably through international trade; but the review of measures which reduce competition in labour markets can also play a significant role in this respect.

138. Improving the functioning of the labour market requires more than changes in pay determination -- it is intimately linked to improvements in the microeconomic processes by which labour is allocated among competing uses and by which the efficiency of labour utilisation is set: that is, to labour market flexibility. It is clear that long-term relations between firms and their employees can make an important contribution to the efficient development and deployment of skills; and that even the most efficient labour market, far from operating on a "hire and fire" basis, will be characterised by mutual commitments between employers and workers as each makes costly and largely sunk investments in competence and understanding. But the experience of the last decade shows that many government-imposed restrictions on and distortions to the flexibility of labour markets do nothing to bring these efficiency gains closer; they merely aggravate segmentation in employment, lulling those with jobs into a false sense of security, while worsening the hardship of those who are out of work.

139. As these lessons have become clearer, a substantial reversal has occurred of the legislation and regulations which impeded the microeconomic functioning of labour markets in the 1970s, notably in Europe. Statutory minimum wages now play a reduced role, though they remain highly significant in the Netherlands, Spain and France, where (in 1984) they were equivalent to respectively 65 per cent, 41 per cent and 37 per cent of average manufacturing earnings; administrative constraints on recruitment and lay off decisions have been eased; the fixed element of non-wage labour costs has generally been reduced; and replacement ratios (the ratio of unemployment benefit to



the average income of an employed worker) now do not appear to provide significant disincentives to work. Yet restrictive work practices and inefficient labour utilisation remain significant problems in many countries.

140. This may partly be because certain restrictions on labour utilisation -- especially on internal and external labour mobility -- are being perpetuated through collective bargaining. These impediments are perpetuated even when not legally imposed because they are in the immediate interests of employers and their present employees -- in part because of official policies which limit the extent of competition in product and factor markets. But it needs to be recognised that these immediate interests may be met at the eventual cost of excluding large sectors of the workforce from effective participation in labour markets -- that is, of deepening segmentation between the "insiders", who benefit in higher wages and greater job security from the economic rents restrictions on competition create, and the "outsiders" who bear the costs.

141. There are relatively few specific measures governments can take in this respect, above and beyond supporting improvements in collective bargaining. And even these are unlikely to succeed if they are not underpinned by community understanding -- about what labour market institutions can and cannot achieve; about the evolving constraints to which adjustment must occur; and about the opportunities successful adjustment can create. It is these factors which make it so important to develop a broader consensus between and with unions and employers about the desirability of adjusting to change -- not only in terms of wage-setting, but in terms of adapting working practices and developing a policy dialogue.

142. Developing such a consensus is largely in the self-interest of unions and employers, and it is with them that responsibility ultimately must rest. Consultative procedures at the firm and industry level have a clear role to play in ensuring that employees are aware of changing constraints and opportunities, and that the legitimate concerns they may express are taken into account; such procedures can contribute both to greater productivity on the shop floor and to better collective bargaining outcomes.



143. However, governments too have a responsibility for improving community understanding of economic circumstances and their consequences. The primary role of economic policy in this respect is to set a clear and predictable medium-term framework for the growth of nominal incomes; but as the Japanese experience strikingly demonstrates, a medium-term setting in economic policy need not rule out the continuing search for consensus at the national level with unions and employers' associations, even in collective bargaining structures which are relatively decentralised. Yet experience shows that consultative mechanisms can do little if the incentives and constraints bearing on collective bargaining are not such as to promote recognition of the need for adjustment; so that the search for consensus is an important complement to -- and not substitute for -- a move towards more rational systems of industrial relations.

144. Governments can underpin these efforts to achieve realistic outcomes in labour markets through the proper conduct of their own role as employers. Indeed, collective bargaining poses special problems in the public sector -- and these problems have become more acute over the longer term as the share of the public sector in total employment has risen; in more recent years, they have been further accentuated by budgetary restrictions on public sector pay. The economic consequences, notably of industrial conflicts, have been magnified by the fact that the public sector is the sole provider of services in many areas; so that disputes may have particularly serious implications for economic activity as a whole and cause grave inconvenience to third parties.

145. There are inevitably important differences between what can be achieved in the public and private sectors; but the priorities are similar: improving, where necessary, the legal framework for collective bargaining and enhancing incentives and external constraints. Efficient dispute settlement procedures are one key. Ultimately, however, constraints on public sector wages depend on the effectiveness of budget discipline, including acceptance that excessive wage increases will -- as in the private sector -- lead to employment reductions; and on government willingness to draw on outside suppliers of services if costs are lower. In this sense achieving better wage outcomes in the public sector is closely linked to the review of the public sector's scope -- a topic dealt with below.



### 3. Education and training

146. Over the longer term, the capacity of individuals and indeed of labour markets as a whole to respond to changing circumstances is greatly affected by the adequacy of national education and training systems -- because these systems so heavily condition the depth, breadth and flexibility of skills in the labour force, the ability to perceive and exploit emerging opportunities, and -- perhaps most importantly -- the understanding of the constraints bearing on individual firms and national economies.

147. Yet education and training systems are under pressure from multiple sources: from labour market conditions which preclude many young people from gainful employment for long periods of time and which have led to the proliferation of training programmes relatively poorly coordinated with other components of the education system; from new technologies which alter the desirable type and pattern of education -- and which, together with demographic trends, create a need for greater flexibility in allocating resources within education itself; from the difficulty of monitoring and maintaining quality levels in systems with high levels of enrolments; and -- interacting with all the above -- from budgetary constraints that limit the scope to absorb strains merely by increasing spending.

148. The extent of each of these pressures differs from country to country -- as must the appropriate response. But three priorities for policy can be identified.

149. First, in many countries a need remains, according to the case, to either increase retention rates in secondary education to levels comparable to those in the other advanced economies (see Table 7) or to ensure better co-ordination between school education and the wide variety of training programmes which are provided in other settings, including those within enterprises. Furthermore, in most European countries, there is a need to provide wider and more flexible opportunities for access to tertiary studies for both qualified school leavers and adults. And in many cases, the content and structure of studies beyond compulsory schooling and in training need to be reviewed towards a better balance between general education and the teaching of more specific vocational skills.



Table 7

PATTERNS OF POST-COMPULSORY YOUTH EDUCATION AROUND 1984  
Estimated Ratios in Per Cent of Total Population in Relevant Age Classes  
(Countries Ranked By Total Enrolment Rate at Age 17)

Country	Enrolment of 17-year olds:				Total	Share of age class getting credentials for entry into higher education		Ratio of the number of entrants into higher education to size of an age class (%)		Ratio of the number of persons taking post-secondary degrees to size of an age class (%)	
	School education:					Universities in general	of which: Limited choice only	Universities (2)	Other	"Bachelors"	Lower
	General	Vocational (1)	Apprenticeship, part-time, etc.	Post-secondary, etc.							
Germany	32	18	46	1	97	28	6	17	9	12	8
United States	81	0	..	0	88	73		28 (3)	34 (4)	24 (3)	34 (5)
Netherlands	35	41	10	0	86	50		10	24	6	18
Belgium	78	0	8	0	86	20 (3)	50	12	20	15	..
Sweden	32	51 (6)	2	0	85	77		36	0	15	15 (7)
Japan	53	23	2	5	83	92(8)		26	12	24	11
Switzerland	20	7	55	0	82	14		..	..	..	..
Austria	14	20	44	0	78	13 (3)		17	..	16	..
Canada	67	0	..	9	76	75		..	..	23	13
France	25	38	10	2	75	29		18	12	13	12
Norway	38	36	1	0	75	70 (3)	35	18	..	18 (3)	42 (3)
Denmark	35	33	6	0	74	25 (3)		22	13	14	11
Italy	22 (3)	25 (3)	23 (3)	0 (3)	70	51		27	1	11	1
Australia	37	0	20 (9)	9	66	43		31	17	16	6 (3)
United Kingdom	18	12	35 (10)	0	65	37		17	12	15	12
Spain	34	15	..	0	49	25		15	9	8	6
New Zealand	34	11	0	1	46	..		12	2	11	4
Portugal	38	0	3	0	41	19		..	..	..	..

Note: Comparability of the figures both between countries and within countries is limited as data may come from different sources. By "age class" is meant the total population born in a certain year. The years of reference differ according to the educational patterns typical to each country.

Source: OECD Educational Databank and national statistical publications.



## Notes to Table 7

1. Vocational and technical courses, to the extent that they can be distinguished from general ones (not always an official distinction).
2. Including 4-year colleges, etc.
3. 1981.
4. 1981 figures covering non-university colleges, excluding non-collegiate schools.
5. 1981 figures covering two-year colleges and non-collegiate post-secondary schools with occupational programmes.
6. Two-year upper-secondary courses.
7. The distinction between "batchelor" and "lower" degrees is not official since 1977. The figures for Sweden in the last two columns are therefore estimations based on the total number of first degrees in 1984 and their distribution in 1976.
8. Including diplomas from three and four-year high-school programmes, full-time or part-time, regardless of student age at graduation.
9. Mainly part-time technical education.
10. Including further education, private and public part-time study and the Youth Training Scheme.



150. Second, higher levels of secondary enrolment, and the consequent expansion in the school system, can bring in their train severe problems in maintaining standards and in ensuring flexible adjustment to changing educational needs. An important step in both these respects is to improve the resource allocation process between and within educational sectors, so that it provides incentives for schools and training institutions themselves to enforce standards and adapt to demand trends.

151. In particular, there is a strong case for more parental choice and diversified opportunities in the education and training system, both within the public sector and between public and private providers. But it is important that a shift towards more diversified provision be accompanied by measures to maintain equity and promote equal opportunity -- notably by providing relatively greater resources to schools in disadvantaged areas and for the education of social groups which tend to fail in the school system and then in the labour market.

152. Third, in virtually all OECD countries there is scope for increasing the adequacy of training and retraining facilities for adults. The need to do so is rendered urgent by present labour market conditions as well as by broader equity considerations; but it is underscored by longer term demographic trends. Given these trends, the educational system itself -- if it is to maintain its claim on resources -- will have to expand its role as a provider of recurrent education; and it is particularly important that it do so, because in an economy undergoing rapid structural change, but where the working population is growing very slowly or even declining, additions and retirements from the labour force will no longer provide an effective means of adjusting the supply of skills. However, efficiently discharging this function will require greater openness in the formal educational system to the growing amount of training activity which takes place in other settings.

153. Desirable improvements in the quantity and quality of education will often involve considerable expenditure. New ways of financing education may have to be investigated, unless significantly increased costs can be covered in present systems. Particularly for higher education, there appears to be scope in many countries for increasing the financial contributions made by



students and from other private sources -- although it is also essential that there be adequate systems of financial support for students from low-income families as well as student loans available more generally. A greater reliance on private funding may appear to conflict with declared equity goals but the alternative of not making needed increases in educational provision would hardly be more equitable; and the evidence suggests that the benefits of publicly-funded higher education do not primarily accrue to students from low-income families. The diffusion of tertiary education would be more effectively stimulated by reducing present inequities in educational attainment and quality at primary and secondary levels while using higher levels of cost-recovery to expand the number of places available in universities and other tertiary institutions.

### C. Efficiency and effectiveness in the public sector

154. Overall, the interaction of enhanced incentives in product markets and increased responsiveness in factor markets should provide a sound basis for improving performance overall; yet the gains in performance are likely to be considerably greater insofar as they are accompanied by improved efficiency and effectiveness in the public sector.

155. This is most obviously because the public sector now accounts for so large a share of societies' use of resources -- and yet the processes by which these resources are allocated and the efficiency with which they are employed very largely escape the control of market processes. But it is also because the functioning of product and factor markets is so strongly influenced by the conduct of the public sector -- not only directly, through the purchasing, spending and taxing functions of government, but also indirectly, as in the linkages between public and private sector collective bargaining.

156. Many of the problems of the public sector today arise from its previous growth; because the efficient management of resources is far more complicated when it is carried out at the public sector's present size and diversity, than at the scale of even only two decades ago; and because the impacts of public programmes on overall efficiency may alter as spending rises and coverage expands. But the need to reform the public sector also comes from the



imperative of adapting to change: of reviewing programmes whose goals have been met or whose underlying premises are no longer valid; of adjusting overall spending and taxing to the altered trend of growth; and of developing new forms of co-operation between the public and private sector.

157. What is required is a continued search for cost-efficiency in public management: for ways of attaining public objectives at an acceptable resource cost. It is by no means obvious that this requires any sacrifice of social goals; but what it does require is greater emphasis on incentives for improving the quality and grade of service, eliminating unnecessary expense, reallocating resources more flexibly, achieving greater transparency and accountability, and for more carefully weighing the costs of a course of action against its benefits. Such an emphasis is important both in the internal conduct of the public sector's affairs and in its relations to the economy more generally.

#### 1. Regulation and the scope of the public sector

158. A first step is to review the functions carried out by the public sector. These of course vary greatly from country to country; but in all countries the burden on public management could be eased both by more broadly decentralising the implementation process within government to regional and local authorities, and by improving the balance of activities between the public sector and private provision.

159. The need for review is particularly great in the area of the regulation. There is no blanket case for removing all regulations; indeed, notably in the environmental area, and in the protection of health and safety, public action is essential -- though here too it is important that the regulations adopted be such as to achieve their objectives in the most cost-effective manner and while leaving the greatest room for innovation and the working of market forces.

160. There are, however, strong arguments for reforming the economic regulation of industries and firms -- that is, the process by which government issues instructions which alter the resource allocation decisions of private



agents. These arguments are partly negative: that is, based on visible inefficiencies in the way regulated industries operate, set prices and decide on investment. But they are also based on the fact that liberalising regulations yields benefits which go well beyond the measureable costs of regulation -- benefits in the form of technological and organisational innovation and of enhanced dynamism in the economy as a whole.

161. Thus in the transport industries, where governments have traditionally exercised far-reaching controls over prices and output, it has become apparent that considerable gains can be obtained through greater exposure to market forces. In effect, far from serving social objectives, the net impact of regulatory controls has been frequently to raise costs, distort prices and perpetuate excess capacity; and where industries have been deregulated, prices have come down, the frequency of service has often improved, and demand has generally increased significantly.

162. Deregulation in these industries has typically not led to a deterioration in service to smaller and rural communities -- indeed, organisational innovations and increases in efficiency have usually made it easier to ensure affordable service even to remote areas. Nor has deregulation typically resulted in "destructive competition" -- although industry structures have tended to change in the immediate wake of market opening, and continue to shift in line with market circumstances, the broad pattern has been one of workable and effective competition.

163. The industries which have been traditionally considered as "natural monopolies" -- that is, as being most efficiently served by a single supplier -- pose more complex regulatory problems. These problems are inherent in technologies which provide incumbent firms with a large cost advantage over potential rivals, and thus undermine the effectiveness of competitive disciplines. But even in these industries, there is frequently significant scope for competition; and the experience of the telecommunications industry highlights the gains that a shift to competition can generate -- so long as the policies through which this shift occurs are mindful of the distinctive characteristics of these industries' technologies, of the need to provide adequate safeguards for new suppliers, and of



difficulties which can arise for consumers from abrupt changes in prices and conditions of services.

164. It is therefore likely that even in a more competitive environment, there will be a need for continuing regulation of the industries traditionally considered natural monopolies, both to prevent the abuse of dominant positions and to ease the transition problems a move to competitive provision may create. But regulatory procedures should be such as to maximise the incentives for efficient supply; a promising approach in this respect is that of regulating by setting a maximum rate at which the price of the regulated service can increase relative to the retail price index. At the same time, full application to these industries of competition policies can strengthen the safeguards provided to firms seeking to enter the market.

165. Both in these industries and in others, obtaining the greatest benefits from regulatory reform may require a review of the status and operation of public enterprises.

166. Ultimately, the ownership of companies matters far less than the efficiency of their operation; and it is a competitive product market which -- by ensuring that the most efficient firms displace their rivals -- provides the key conditions in this respect. It is consequently essential to enhance the competitive environment in which public enterprises operate; and this can be accompanied by measures to place public enterprises on a more commercial footing. Enhancing public enterprises' operating autonomy, clarifying the functions and objectives of their boards and strengthening accountability through more transparent financial arrangements are important elements in this respect. The transfer of public enterprises to private ownership may well bring further gains, both by reducing the scope for political interference and by subjecting the firms' operating efficiency to monitoring by equity markets; though there is an undoubted trend in this direction, the experience is too recent to provide a basis for systematic analysis.



## 2. Social policies

167. Overall, the reform of regulation does not in general imply the abandonment of longstanding public objectives -- it simply involves recognising that these objectives can better be met in a modified framework. This need to adapt the institutional framework most efficiently to meet the objectives of governments also underlies the reform of social policies.

168. Here too, the strengthening of incentives must play a key role. This is firstly because the services these policies involve are now such large industries in their own right -- industries which would be more efficiently run were the incentives for their producers and consumers simpler, clearer and more transparent. But it is also because the present policies are in numerous instances simultaneously incompatible with demographic trends and limited taxable capacity.

169. Thus, by 1984, the health services alone accounted for over 7 per cent of GNP in the OECD area -- and demand for health services will tend to rise further. There are no simple solutions to reconciling the desire for social equity in access to health care with advancing technology and the need to maintain public health expenditures within reasonable budgetary constraints. Though involving a mix of measures, policy in recent years has leaned heavily towards regulation of the supply of services through price and budget controls. Yet there are obvious political and social limits to how far such policies can be pursued. There has also been a trend to increasing user fees for health care, both as a rationing device and as a means of cost-recovery; and there seems to be some room for further shifts in this direction. Ultimately, however, the most promising approach appears to be that of revising the incentives bearing on the supply of health services. A shift to greater competition, in the context of improved information and of increased consumer participation in the financing of health care, would provide suppliers with more direct incentives to contain the costs and improve the quality of service. At the same time, strengthened interaction between insurance organisations -- public and private -- and the health service suppliers could enhance productivity in terms of the health outcomes. "Health Maintenance Organisations" (HMOs), though in many respects specifically



C/MIN(87)3(Final)  
Synthesis Report

adapted to the institutional context of the United States health care system, provide valuable lessons in this respect.

170. Public pension schemes will also face substantial problems as a result of demographic trends. Governments in many countries have committed themselves to providing old-age pensions on a scale which is likely to be incompatible with budgetary constraints and present views of taxable capacity, even were GDP growth rates to increase significantly. The political and economic tensions this will create between pensioners and the active population can be most easily resolved if steps in the direction of reform are taken as of now -- rather than having to implement crisis solutions when the situation has become untenable.

171. Though there are a range of options in this respect, it appears particularly important to increase the funded component of pension schemes. While this can be done in the context of public funded schemes, privately run programmes may prove more effective in developing attractive savings instruments and ensuring efficient placement of the funds collected. But this requires a regulatory context which clearly sets out and enforces responsibilities for operating these programmes and which adequately protects savers. Portability of private pensions is also essential if labour mobility is not to be impeded.

172. Finally, the major challenges facing unemployment compensation systems arise from the need to cope with continuing high levels and long duration of joblessness. Declines in replacement ratios in recent years have created significant hardship especially for the long-term unemployed and also for new entrants to the labour force. The scope for further such reductions will very likely be limited -- though, in many countries, there is room to reduce the disincentive effects of unemployment benefits by making them taxable and tightening up tests of availability for work. At the same time, it appears desirable to accompany recent initiatives for the long term unemployed with a generally greater emphasis on the provision of training, retraining and work experience for those out of work, especially in the countries where unemployment among the unskilled is high; and, more broadly, on measures to enhance the operation of placement services at least where high vacancies co-exist with high unemployment.



### 3. Taxation

173. Improving regulation, reducing its scope and reviewing the framework for the provision of social services should significantly increase the effectiveness of government; but some of the most adverse impacts of the public sector on economic efficiency in the private sector come from the structure and level of taxation.

174. The problems are familiar. They arise from high marginal tax rates, which create incentives for evasion and avoidance, distort the allocation of resources, notably for investment, and reduce the supply of labour, and from tax provisions which discriminate more or less arbitrarily between broadly similar activities.

175. These costs can to some extent be attenuated by altering the structure of taxation. There are three important elements in this respect. The first is to reduce those marginal tax rates that have high disincentive effects (possibly as a result of their interaction with eligibility rules for social benefits) -- because these almost invariably cause damage far in excess of the revenue they raise. Inevitably, concerns about equity are involved; but it is well to consider whether the pattern of marginal rates actually contributes effectively to the desired redistribution -- and the income tax system is certainly a less effective tool for achieving an equitable income distribution than are full employment and well-functioning social policies.

176. The second element is to eliminate differences in tax rates applying to essentially similar transactions. Such differences ultimately lower revenue, and the occasional benefits they bring are typically overwhelmed by the damage they do to economic growth, as well as to the integrity of the tax system.

177. Finally, in the countries where such a shift has not already occurred, there is a strong case for changing the tax structure towards greater reliance on taxes which have a more neutral impact on economic decisions, in particular through a move from income taxes to taxes on consumption, for example, value-added tax.



178. These goals can typically be brought about with no reduction in revenues. Indeed, elimination of tax-based discrimination among similar activities may raise revenues, providing room for a general lowering of tax rates. But while the reform of tax systems can eliminate a great deal of the damage they currently do, the tax burden ultimately reflects the size of public expenditure. The consequences of this expenditure clearly depend on the specific nature of the policies involved; and the overall economic effects of programmes to broaden the skill base or improve basic research are quite different from those of subsidies to industries no longer viable. Yet against the undoubted benefits certain spending programmes may create must be set the costs of financing these through taxation -- costs in terms of eroded incentives and distorted choices. The evidence suggests that these costs are particularly high at the margin -- so that the costs of increasing the size of the public sector, as well as the gains from reducing it, are significantly larger than the average economic cost of public sector spending.

179. This underlines the need to carefully review the quality of public expenditure, to ensure that the benefits obtained from outlays fully justify their costs and to exploit opportunities to reduce public spending relative to national income. Vigorous action in this respect can relatively easily provide both for a selective lowering of extreme tax rates as well as a more general lowering. It can therefore make tax reform a significantly easier undertaking -- but this will require hard economic and political choices about expenditure, and indeed about the appropriate role and responsibilities of government.

### III. THE STRATEGY OF REFORM

180. Reform is therefore needed across a broad range of areas. But the economic desirability of change is hardly sufficient to bring it about; and a decisive shift in the stance of policy inevitably raises concerns and opposition. How can change most effectively be brought about?

181. There are three imperatives in this respect: drawing on broadly shared values of fairness to advance economic reform; capturing the public



imagination through a programme of reform which is broad, bold and sustained; and ensuring that action domestically is reinforced by cooperative action at an international level.

A. Advancing fairness and equity

182. Inevitably, many microeconomic policies are first and foremost about equity -- about attempts to bring market outcomes into line with societies' perceptions of what is just and tolerable. Few would deny that public policies have achieved a great deal in this area -- and the review of these policies creates fears that hardship would be increased and burdens unfairly distributed. Yet, far from compromising widely-shared goals, the reform of present policies would advance the cause of fairness.

183. In some cases, this is because inequitable outcomes are inherent in the policies presently pursued -- in a manner often quite contrary to their original intentions. Thus, as tax levels have risen, increased complexity of income tax structures has greatly diminished their effective progressivity in many countries, in some instances to the point of actually favouring the best-off. Equally, it would be difficult to justify, on any broader social grounds, the redistributive effects of current agricultural policies: redistribution from poorer households to better-off farmers, from smaller to larger landowners. Yet these transfers are the largely unavoidable result of relying on price support as a means of raising agricultural incomes.

184. In other cases, inequities arise because the redistributions induced by the policies are not really under policy-makers' control. Public utilities, for example, typically impose higher prices (relative to cost) on some services to fund lower prices on others -- with the objective of assisting low-income households or those in rural areas; but because the redistributive effect depends on the extent to which different income groups use the various services, the pattern of transfers frequently does not correspond to the stated objectives.



185. And finally, inequities arise from the way policies have been changed in line with budgetary constraints. This is most striking in the case of social insurance: reductions in eligibility for unemployment compensation have created considerable hardship for the long-term unemployed; the costs of rationing public health care have fallen most heavily on the poorer consumers, at least in systems with both public and private providers of health services; if public schooling is cut back it is those who have no options who suffer most. In short, as policies which sought to do too much have been retrenched, the interests of those in genuine need have not been sufficiently protected.

186. These inequities can be diminished -- by the reform of policies which provide rents to some at the expense of many; by carefully assessing whether purported goals of redistribution are actually being met in tax systems, subsidies and social policies; and by more clearly distinguishing income transfers from the supply of social services -- so that more adequate transfers can be targetted at those in need.

187. Reform is also compatible with greater equity because social progress depends so heavily on growth. The major source of hardship in the OECD countries is almost certainly current high unemployment -- and that unemployment is the principal cause of increased inequality in the distribution of income and of social opportunities. Relieving poverty and attaining a fairer distribution of life-chances hinges to a considerable extent on returning the advanced economies to sustainable, job-creating, growth -- yet this will be more difficult to achieve and maintain without the extensive review of microeconomic policies.

188. However, the move to a more competitive environment will not be painless, even in a context of improved economic performance -- and a continuing process of adjustment involves "losers" as well as "winners". A recognition of social obligations is an important part of democratic values; and it is natural and desirable that help should be available for those who need assistance to obtain and sustain a standard of living judged socially acceptable. Perhaps the greatest help is that which allows individuals to return to a useful and productive life, freer if not free of dependance on the



public purse; and it is here that much remains to be done, through the more broadly based provision of education, training and retraining, by taking effective measures to assist the long-term unemployed, and by removing "poverty traps" which discourage responsiveness to job opportunities -- but also by shifting policies onto a path supportive of overall growth. Economic and social policies therefore have a broadly complementary role in allowing as many people as possible to play an active role in society.

B. A broad approach to action

189. The case for reform consequently goes beyond considerations of economic efficiency alone. But reform depends on more than convincing arguments; it hinges on the capacity of governments to secure broadly-based support for change.

190. Approaching the reform of microeconomic policy as a whole can facilitate this process. There are clear economic benefits to reform on a broad front -- and the mutually-reinforcing nature of the measures adopted would make the gains not only greater but more readily visible. At the same time, the broadness of a programme of reform, which tackled the measures favouring narrow sectional interest at the general expense, would mobilise support through its evenhandedness and non-discriminatory nature -- as recent experience with tax reform confirms. Finally, a bold approach, promising determined action across a range of areas, is more likely to capture the public imagination and highlight the opportunities change creates.

191. To be viable, a programme of reform also needs to be sustained -- to provide time for the cumulative effects of measures to be felt, to allow for learning and experimentation, and to ensure that initial steps are not subsequently reversed. A commitment to transparency -- the process of periodic, public and independent policy review -- can support the momentum for change over the longer term and facilitate community understanding of needed policy adjustments. At the same time, public discussion and dialogue about policy reform can broaden the base of support and help avert the polarisation of conflicting points of view.



192. Such an approach can facilitate the task of economic reform; but it cannot make reform easy. Combined, fear of the unknown, the inertia of established procedures, and hostility by the vested interests can provide powerful forces obstructing change. Ultimately, overcoming these forces can only depend upon political leadership -- on the willingness of governments and oppositions to make possible what is desirable.

### C. The international dimension

193. Nowhere is political leadership more important than in the international arena -- for here the difficulties of exercising responsibility and ensuring better outcomes are greatest. But the effective functioning of the international economic system is not only an essential goal of economic reform; it can also bolster efforts domestically to place microeconomic policy on a new course.

194. International agreements play an essential role in this respect: for they create a framework of rules and obligations which limit the scope for interest group pressures domestically, while increasing the legitimacy of change by visibly sharing its burdens and opportunities. Conversely, a weakening respect for international obligations -- as has so markedly occurred over the last decade in the trading system -- can only render domestic adjustment more difficult, encouraging rent-seeking and the narrow pursuit of sectional interests, while misleading communities into the belief that change can be postponed or even entirely avoided.

195. Present circumstances make it all the more important that the gains from cooperative action be exploited. A prospect of continued slow growth cannot be avoided without determined action to create an international environment conducive to expansion. In particular, it is essential that macroeconomic policies be brought into a medium-term, internationally compatible orientation which can reduce current imbalances and prevent the development of new disequilibria. But steps in this direction are not a substitute for the reform of structural policies; and action on the microeconomic front cannot and should not be postponed until all features of economic circumstances are entirely favourable.



196. This is because securing improved microeconomic behaviour takes time: because the range of areas in which policy reform is needed is so great; because the process of policy reform is slow and complex; and because the lags between the changes in policy and shifts in outcomes are frequently long. Yet, experience has shown time and again that expansions cannot be maintained, and the cost of the ensuing recessions is greatest, when the structural components of economies are functioning poorly: when labour markets respond to stimulus through unsustainable wage outcomes; when firms increase prices rather than output as demand rises; when possibilities for reducing costs, increasing efficiency and introducing new products are passed by; and when taxes and transfers blunt the incentives for growth.

197. It is for these reasons that the problems of microeconomic policy are crucial -- for unless they are resolved, a return to sustainable growth is unlikely; and the gap between what is achieved and what communities could legitimately and realistically expect will remain unacceptably large.



CONFIDENTIAL

ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

CONFIDENTIAL

Paris, drafted: 21st April 1987

dist: 22nd April 1987

C/MIN(87)9(Final)

Or. Engl.

COUNCIL  
AT MINISTERIAL LEVEL

STRENGTHENED TRANSPARENCY AND DISCIPLINE  
IN THE FIELD OF TIED AID CREDITS AND  
ASSOCIATED FINANCING OF EXPORTS

(Report by the Chairman of the Export Credit Bodies)

The attached report sets out the action taken, in pursuance of the instructions given by the Council at Ministerial level in April 1985 [cf. C(85)62, para. 14 b)], by the Participants in the Arrangement on Guidelines for Officially Supported Export Credits. This report has been signed by both Mr. Axel Wallen (Sweden), who chaired the export credit bodies from February 1980 until their meetings in January 1987, and by Mr. John Coleman (Canada), who was elected Chairman at the end of these meetings.

04 156

CONFIDENTIAL

6783T



STRENGTHENED TRANSPARENCY AND DISCIPLINE  
IN THE FIELD OF TIED AID CREDITS AND  
ASSOCIATED FINANCING OF EXPORTS

1. The May 1984 OECD Ministerial Council called on the Participants in the Arrangement on Guidelines for Officially Supported Export Credits to take prompt action to improve existing arrangements in the field of aid and trade related concessional finance. This led to the April 1985 OECD Ministerial Council's decision to reinforce notification and consultation procedures and to increase the minimum permissible grant element for tied aid credits and associated financing. When agreeing on this "first step", the Ministers also decided that measures aiming at strengthening transparency and discipline in this field should continue to be pursued. In this context, the Ministers asked that a study be compiled by the end of September 1985 so that new measures aiming at a further increase in discipline and transparency could be taken.

2. The study was completed as instructed. On this basis, intensive discussions took place in both the plenary meetings of the Participants and informal consultations by the Chairman. Drawing on these meetings and consultations, the Chairman transmitted to the April 1986 OECD Ministerial Council a set of suggestions that he felt had the support of a considerable number of participants [Annex to C/MIN(86)8(Final)]. These ideas aimed at further reducing trade distorting elements in current tied aid financing practices, including measuring more equitably a country's actual costs of providing aid. However, there were differences of views on certain aspects of this package, and no action could be taken at that meeting.



3. The Chairman thus continued his consultations, seeking to devise a more broadly based, balanced package of measures. In order to facilitate agreement on such a package, he worked closely with participants and with the Secretariat on the revision of commercial interest reference rates (CIRRs). As a result CIRRs for the currencies used by participants have been developed and accepted.

4. By December 1986, the Chairman felt that consultations had progressed to the point where he could propose a revised package of measures to strengthen the rules of the Arrangement. This package contained the following elements:

- staged increase in the minimum permissible concessionality level of tied aid credits to 35 per cent;
- revision of the formula for calculating the concessionality level so as to reflect on a more equal basis the cost to donor countries of providing these credits;
- complete elimination of remaining subsidies in official export financing support to relatively rich countries plus a staged reduction of such subsidies for exports to other countries;
- agreement not to reopen the question again for at least a year after implementation unless there is a sharp grouping of export credit offers just above the new minimum permissible concessionality level.

5. In this package, the formula for calculating the concessionality level and the proposal for eliminating or reducing the subsidy element in export credits were both aimed at improving its overall balance.



6. After extensive discussion at the January 1987 meeting of the Participants, the Commission of the European Economic Communities put forth a compromise proposal (attached) based on, but going in certain respects somewhat further than, the Chairman's proposal: this applies in particular to a strengthened formula for calculating the concessionality level. As a large majority favoured the Commission's proposal, the Chairman concluded that all participants should take it back to capitals to consider whether it could be formally accepted.

7. This compromise proposal was accepted by all participants in the Arrangement in March of this year. The Participants met again this April and agreed on a number of measures that are necessary for its implementation, which will be in two steps: the first in July 1987 and the second in July 1988. These measures apply only to the Arrangement and therefore shall affect neither the definition of official development assistance (ODA) nor the reporting of ODA commitments and disbursements under the Development Assistance Committee.

8. This agreement represents a major step toward the goals of the Arrangement: increasing order and transparency and eliminating trade distorting subsidies in the field of trade related finance. Future work of the export credit bodies will aim at effectively implementing the Arrangement as modified and at seeking to improve further international co-operation in export credit matters.



ATTACHMENT

PROPOSAL

BY THE COMMISSION OF THE EUROPEAN COMMUNITIES

1. First stage

- (a) The minimum concessionality level for tied and partially untied aid credits to LLDCs will be increased to 50 per cent.

The minimum concessionality level for tied and partially untied aid credits to all other developing countries will be increased to 30 per cent.

- (b) The discount rate for calculating the concessionality level will be related to the CIRR for each currency and will be calculated as follows:

$$\text{CIRR} + 1/2 (10 - \text{CIRR})$$

- (c) These measures will enter into force on 1st July 1987.

2. Second stage

- (a) The minimum concessionality level for tied and partially untied aid will be increased to 35 per cent for developing countries other than LLDC.



CONFIDENTIAL

6

C/MIN(87)9(Final)

- (b) The discount rate for calculating the concessionality level will be calculated as follows:

$$\text{CIRR} + 1/4 (10 - \text{CIRR})$$

- (c) The interest rate subsidies for importing countries in category I of the matrix will be abolished. The matrix interest rates for importing countries in categories II and III will be increased by 30 basis points.
- (d) These measures will enter into force on 1st July 1988.

CONFIDENTIAL



CONFIDENTIAL

ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

CONFIDENTIAL

Paris, drafted: 23rd April 1987

dist: 24th April 1987

C/MIN(87)7(Final)

Or. Fr.

COUNCIL  
AT MINISTERIAL LEVEL

TRADE IN SERVICES

(Report by the Secretary-General)

I. INTRODUCTION

1. At their last meeting in April 1986, Ministers requested the Secretary-General to report in 1987 on the progress of work on trade in services (see paragraph 30 of the Communiqué of the 1986 Council at Ministerial level [C(86)56]). This report responds to that request.

II. GENERAL ASSESSMENT

2. The progress of work on trade in services can be evaluated in terms of the two principal objectives of the Organisation in this domain. The first objective is to intensify activities aimed at liberalising trade in services



among Member countries through existing OECD instruments. The second is to contribute as effectively as possible to the Uruguay Round negotiations, but without hampering the negotiating process which involves many third countries.

3. Concerning the first objective, active work on the OECD Codes and other instruments has led to tangible achievements in some areas and to encouraging progress in others. New or extended obligations, as well as the lifting of reservations with respect to certain of these obligations, has resulted in increased liberalisation -- in particular, at this stage, in the area of insurance. The revised procedures of the Committee on Capital Movements and Invisibles Transactions (CMIT) and its enlarged membership -- now at twenty -- should increase the effectiveness of the Committee's work.

4. With respect to the second objective, the decision at Punta del Este to include services in the Uruguay Round of trade negotiations is a major event in international co-operation. Certain of the Organisation's activities are conducted with the idea of contributing to these negotiations as well as providing an impetus to general reflection on the problems of liberalisation of trade in services. In particular, the work on a conceptual framework for liberalisation of trade in services is in line with the objectives set by participants in the Uruguay Round. A document entitled "Elements of a conceptual framework for trade in services" has been derestricted under the Secretariat's responsibility. This will enable all concerned, especially in the context of the Uruguay Round, to be informed about the ideas developed in the OECD. The examination, already underway, of the applicability of the general concepts to the principal service sectors is important both for improving the conceptual framework itself and for identifying specific sectoral issues.

5. It is also clear that work on the OECD Codes and other instruments -- especially extension of the activities covered and the drafting of new obligations -- contributes to substantive reflection in Geneva. This contribution is made, in particular, through various sectoral activities which are being integrated into the more general work, and thus increasingly take account of the global dimension of service-related issues.



6. Obviously the nature and scope of the OECD contribution will depend on how the multilateral negotiations develop. These negotiations have just begun and, beyond their general objectives, many specific aspects will become clear only gradually. It is in the light of these developments that OECD activities may have to be reassessed, more clearly defined, or redirected. Any questions regarding compatibility between the approaches followed by the OECD and those followed in the Uruguay Round would naturally be examined in due course.

7. Two requirements can already be identified. First, work should be intensified to analyse the role of different service sectors in the economies of developing countries and the contribution to economic development which could be made by an expansion of trade in services. Second, despite progress achieved, an important effort is still needed, as rapidly as possible, to improve statistical data on trade in services -- not only concerning cross-border transactions, but also transactions based on establishment in foreign markets.

### III. THE ORGANISATION'S ACTIVITIES

8. Principal recent developments as well as orientations for future activities of the Organisation are briefly summarised below.

#### A. OECD instruments

9. Work to update and improve the OECD instruments has been stepped up appreciably during the past year. The Committee on Capital Movements and Invisible Transactions (CMIT), working with the relevant sectoral Committees, has completed or almost completed its examinations of restrictions on freedom of trade in services for insurance and tourism, in light of the extended obligations recently undertaken by Member countries. This process has led to the elimination or reduction in scope of a number of Member country reservations which cannot, under the Codes, be reinvoked. Furthermore, these examinations conclude with Council Recommendations inviting the countries concerned to reduce or lift certain of the remaining restrictions.



10. Further steps are also being taken in sectors in which the new information and communications technologies play a large part. The CMIT Committee has completed its proposals to the Council for updating the provisions of the Code of Liberalisation of Invisible Operations with respect to audiovisual works. The proposed extended obligations would concern the transmission of such works by cable or satellite. Similar updating work is under way concerning the banking and financial services -- which also have experienced innovation on a large scale in recent years.

11. Significant progress has been made in the maritime transport sector. After prolonged efforts, the Maritime Transport and CMIT Committees have drawn up a Recommendation and a Resolution, approved by the Council, which extend the commitments of Member countries, and make it possible to begin a new stage of work on liberalisation in this complex sector.

12. There has also been progress with respect to the intersectoral dimension of work on the OECD instruments. Member countries' commitments with regard to the establishment of non-resident enterprises have been clarified and strengthened, taking into account, in particular, existing reciprocal practices on establishment. All of these measures are now the subject of periodic examination in the CMIT Committee. The Committee on International Investment and Multinational Enterprises (CIME) has completed an examination under the National Treatment Instrument of restrictions on investment by established foreign-controlled enterprises. An examination of measures which limit other activities by such enterprises in the services sectors is under way.

13. The procedures of the CMIT Committee have been modified in an effort to increase their effectiveness and flexibility and to make possible wider participation, while keeping intact the Committee's expert character and independence. In the coming months members appointed by twenty countries will participate directly. This reform should serve to increase the Committee's efficiency and the relevance of its work to policy-making in capitals.

#### B. Conceptual framework for trade in services

14. Work is proceeding actively on verifying the relevance to the principal service sectors of the conceptual framework developed under the aegis of the



Trade Committee. Preliminary examinations of five sectors (maritime transport; insurance; banking and financial services; tourism and international travel; information, computer and communications services) have already been carried out. Documentation on business, engineering consultancy and construction services is now being prepared. In the case of services linked to the transfer and processing of computerised data, the Committee for Information, Computer and Communications Policy (ICCP) and its Working Party on Transborder Data Flows, in collaboration with the Trade Committee, are compiling the basic documentation.

15. Thus far, this exercise has confirmed the general relevance of the conceptual framework to the principal service sectors. To the extent that they exist within the OECD, committees and working parties which cover these sectors will examine this documentation in order to provide their expert view of the relevance of the framework and to identify important sector-specific issues.

16. In its present state, the conceptual framework constitutes an important contribution to international analysis of liberalisation of trade in services. Work to improve and further refine the framework will be pursued. This work will be based, first, on the results of the examination of its applicability to the principal service sectors, and, second, on a further analysis of certain of its elements. This exercise, led by the Trade Committee, may be enriched by observations from other committees, notably the CMIT, which can look at the conceptual framework in light of their experience with the OECD instruments.

### C. Other activities

17. Among other activities related to trade in services, the work of the ICCP Committee and of its Working Party on Transborder Data Flows deserves particular mention. It has consisted of verifying the applicability of the conceptual framework to information, computer and communications services, thereby contributing to the activities of a more general nature described above. In view of the sector's complexity -- the result of continuing rapid innovation in electronics and of changes in telecommunications policies in Member countries -- there will be a need further to deepen the analysis in



certain areas. This will serve the Committee's own purposes and also contribute to work elsewhere in the Organisation. In addition, the ICCP Committee is preparing a report on the internationalisation of software and computer services, covering some trade-related issues including obstacles to trade in these sectors.

18. The Industry Committee is also undertaking a project on the contribution of services to businesses and particularly of technical engineering services to industrial production; this project is partly devoted to the internationalisation of engineering services.

#### D. Statistics

19. Work is continuing in two directions. First, efforts are being made to collect, in a relatively short time, quantitative data geared to the way in which liberalisation of trade in services may be approached in the Uruguay Round. Balance-of-payments data have been improved, and the derestriction of a paper on this subject is being considered. These data are not yet entirely satisfactory, notably from the standpoint of comparability; their principal shortcoming is that they give only a very partial quantitative picture of international trade in services. Efforts are being made, with the help of OECD bodies engaged in statistical work in their own particular sectors, to collect any further information that may be available.

20. As its second line of action, the Organisation is contributing to work under the aegis of the United Nations on standardization of balance-of-payments statistics concerned with services. The Secretariat is playing an active part in this work and Member countries' comments are useful in preparing its contribution.

#### IV. CO-ORDINATING ACTIVITIES

21. Because of its experience and the diversity of its services-related activities, the Organisation can make a significant contribution to international co-operation in this field. In order to ensure coherence and



maximum efficiency, however, close co-ordination is necessary. Last year the Council at Ministerial level "requested that co-ordination within the area of services be intensified, particularly between the competent Committees" [C/M(86)7(Final), page 127, item 78 ii]. Various steps have been taken in this sense in recent years and efforts are continuing.

22. Periodic meetings of the Chairmen of the three Committees with an intersectoral competence in the services field (the CIME, the CMIT Committee and the Trade Committee), and the creation over the past few years of joint working parties which provide an overall framework for sectoral work, have been a response to this requirement. Co-ordination has been further strengthened during the past year. In particular, in November 1986, the Secretary-General organised a meeting of all of the Chairmen of committees and working parties concerned with trade in services. The meeting reviewed activities as a whole and discussed the structures specific to each and the links between them, as well as ways of further improving co-ordination.

23. Some of the meeting's most noteworthy conclusions as well as follow-up actions deserve to be underlined:

-- Better information is the key to better co-ordination. To this end, an "Information Letter" on OECD activities concerned with trade in services will be issued several times a year; the first was distributed in February.

-- Co-operation among committees is developing in a flexible and informal manner through exchanges of documents and requests for assistance and comments. This approach should be pursued.

-- The arrangements for informal meetings of Chairmen of the horizontal committees should be maintained, and Chairmen of other committees should be invited to attend when appropriate. A second meeting of the Chairmen of all relevant committees and working parties to discuss questions of substance -- in particular developments in the Uruguay Round and their possible implications for the Organisation's work -- will be held at an appropriate time.



- Responsibility for co-ordinating the statistical work of the different committees and working parties has been centralised within the Secretariat. This should facilitate the participation of the various bodies in the collection of statistical data that will be useful in the short term in the context of the negotiations and in developing the contribution of the Organisation to international efforts to standardize statistics.

## V. CONCLUSIONS

24. Since the last meeting of the Council at Ministerial level, work has gone forward in a positive manner, and appreciable progress has been made in carrying out the programme which had been presented to Ministers at that time [C/MIN(86)6(Final), paragraph 25].

25. The following points in particular deserve to be highlighted:

- i) The value of the OECD instruments for co-operation and liberalisation of trade in services among Member countries has been demonstrated by the tangible results achieved -- through the updating of the Codes, and by the elaboration of new or extended obligations, as well as by the lifting of a number of reservations, particularly in the insurance sector. It is important to pursue work to improve the effectiveness of the Codes and to expand awareness of their significance. This should help to safeguard what has already been accomplished, to promote further liberalisation among Member countries and also contribute to broader multilateral efforts.
- ii) The conceptual framework for trade in services which has been derestricted for general distribution constitutes an important contribution to general analysis of liberalisation of trade in services, and in particular to the analysis which is being undertaken in the Uruguay Round. This work will be pursued in order to refine the elements of the conceptual framework, itself, and to identify possible sector-specific issues.



- iii) Improvement of statistical data which would provide a more complete picture of international trade in services is an priority task for the Organisation.
  
- iv) The co-ordination and coherence of the Organisation's activities have been strengthened by various means, notably improved information sharing and communication among the committees concerned. It is to be hoped that, as a result, the necessary co-ordination in capitals will be facilitated and work on-the-spot in the OECD will be more productive.



B/f 6/5 (for OECD) briefly mty

FROM: A BOTTRILL  
DATE: 28 APRIL 1987

Ch  
This is stuff Peter spoke to you about. Found message for him was no case for raising Page until Peter's back on Friday

I have comments on latter on submission.

AB

MR S MATTHEWS

OECD ECONOMIC OUTLOOK

Peter Sedgwick has asked me to let you have the attached material for your use in discussion with the OECD Secretariat. This includes

- (i) A general comment on the Secretariat's forecasts and policy appraisal.
- (ii) Detailed drafting suggestions on the Country Note for the UK.
- (iii) Comments on the references in the Secretariat's General Assessment paper to UK monetary and fiscal policies.

3. Although the OECD does not publish its Assessment section of the Country Note, we have provided detailed comments on this as well as on those paragraphs which are to be published. The Secretariat should be made aware of our problems with the Assessment.

AB Bottrill

A BOTTRILL



COMMENTS ON THE OECD FORECAST AND POLICY APPRAISAL FOR THE UNITED KINGDOM

There are substantial problems with the forecasts for inflation, the current account, and the fiscal position in the Secretariat documents, and with the conclusions on the stance of policy drawn from these. The OECD Secretariat forecasts are

	1987	1988
Consumer prices	4½	5
GDP deflator	4½	5½
Current account (\$b.)	-6½	-7½
General Government Financial Deficit ((£b.)	12	12½

2. In recent months inflation has been running, if anything, below the Treasury's expectations at the time of the FSBR. The Treasury's forecast of a 3½ per cent rise in both the CED and the GDP deflator are as high as it is realistic to go in 1987 in the light of the information now available; and given the fall in private sector pay settlements since last year there is certainly not a strong case for forecasting a pick up in inflation next year.

3. The OECD'S current account forecast is well out of line not only with the Treasury's published forecast, but also with the consensus of outside UK forecasters, which is for £2½-£2½ billion deficits in both 1987 and 1988. The current account figures for January and February of this year show a small surplus. QI £0.6bn

4. The OECD projections for the General Government Financial Deficit show a rise over the next two years rather than the fall that the FSBR implies. The suggestion (especially in paragraph 12 of the notes on the UK) that prudence would dictate less favourable projections for government revenues than set out in the FSBR seems very wide of the mark, given the deliberately cautious nature of the projections for revenue in the FSBR. We have no reason to doubt that the borrowing figures in the MTF5 can be achieved. Public expenditure is likely to continue falling as a share of GDP, as it has done since 1982-83; and



even if it were not to do so this would limit the scope for tax cuts rather than jeopardise the PSBR objectives.

5. The conclusions on policy drawn from the Secretariat's interpretation of recent performance and its view of prospects are that the macroeconomic policy stance is excessively expansionary, that this is the cause of the UK'S relatively fast growth rate, and that serious problems with inflation and the current account are imminent. It is very difficult indeed to square these conclusions with a detailed assessment of recent trends and prospects. It is not a balanced view of the current position of the UK economy or of the government's approach to macroeconomic policy.

6. Policy is designed to deliver growth of money GDP in line with the medium term path set out in table 2.1 of the MTF5. The assessment notes that the projections of money GDP growth in the MTF5 this year are higher than those in the 1986 MTF5. It should also recognise that:

- the growth of money GDP over the two years 1986-87 and 1987-88 is much as envisaged in 1986, though there is a difference of timing;
- the difference in the projections of money GDP in the later years ( $\frac{1}{2}$  per cent per annum) is very small indeed in relation to the normal variability of money GDP growth rates, the errors in the money GDP data, and especially the differences in money GDP observed over time in the UK and also between countries.

7. More detailed comments on the text for the UK are attached.



## DETAILED COMMENTS ON THE COUNTRY NOTE FOR THE UK

PARAGRAPH 1, first sentence. Insert "steady" before " expansion".

second sentence. Redraft the opening as "Oil production, representing about 6 per cent of total output, levelled off in 1986, but...."

Third sentence. There has been only a marginal fall in the saving ratio, and the reference to a "sharp increase in borrowing....to finance spending" is misleading. As throughout the 1980s, the rise in personal debt has been accompanied by a similar rise in assets.

Fourth sentence. It is not clear what the first part of this sentence means? The government continued to take the behaviour of sterling into account in setting interest rates, and indeed real interest rates were at relatively high levels in 1986. While the government was certainly content to accept a lower level of sterling than it otherwise would have done because of the fall in oil prices, this is far from "discontinuing support" for sterling.

PARAGRAPH 2 First sentence: Refer to a "small" overshooting of public spending targets.

Second sentence; "partly because of" rather than "reflecting", because the fall in the PSBR in 1986-87 (as now published) exceeded the rise in public asset sales.

Fourth sentence; This sentence implies that higher expenditure than set out in the MTF5 would lead to a larger PSBR or "fiscal boost". This is not the logic of the MTF5: rather, the scale of tax cuts is dependent on the success in controlling public expenditure.



Sixth sentence; The GDP deflator - which is under discussion here -, shows no "recent reacceleration of inflation".

Final sentence; This does not accurately reflect monetary policy as described in the MTF5 and elsewhere. Monetary policy is not simply aimed at the "stabilisation of the exchange rate".

PARAGRAPH 3, Third sentence: Replace "unemployment is projected to drop somewhat" with "unemployment is likely to fall further, continuing the downward trend seen since late 1986".

Fourth sentence: Replace "largely" with "partly".

Final sentence: This raises substantive questions on the forecasts for inflation and the current account, and gives a very misleading impression of the prospects for the economy. It should be redrafted in the light of the comments on the forecast numbers made at the recent meeting of short term forecasters.

PARAGRAPH 4; First sentence: this needs to be redrafted to reflect a realistic projection of inflation in the next two years.

Fourth sentence: This should be replaced by something like "the rise in unit labour cost which have decelerated markedly recently, may pick up again to the extent that any cyclical...." Note that for much of 1986 the cycle was having an adverse effect on labour cost growth - part of the recent improvement is due to the elimination of this earlier adverse cyclical impact.

Penultimate sentence: The logic of this sentence is wrong. The fastest period of growth in consumption and the associated rise in imports is in the past, not the future.



Final sentence: "Rising import penetration" is typical of most OECD countries. It does not necessarily reflect "supply weaknesses".

PARAGRAPH 5, First two sentences: It is not at all clear what the first two sentences are arguing. Growth in MO has been close to the centre of its target range, and the exchange rate has been rising on balance since the autumn, interest rates are high by international standards, and, in real terms, the PSBR has been falling. On broad money "the authorities have made it quite clear" that its message is very difficult to interpret because of financial innovation, etc. Nevertheless, as the Chancellor made clear in the Mansion House speech (16 October 1986), there is every sign that people are holding increased amounts of money quite willingly. So long as this remains the case, its growth is not inflationary.

PARAGRAPH 6, Final sentence: This needs to be revised in the light of the very latest figures for manufacturing output.

PARAGRAPH 7, Third sentence: The volume of public consumption actually rose by  $\frac{1}{4}$  per cent in 1985 and by  $1\frac{1}{4}$  per cent in 1986. These numbers do not suggest that it "picked up markedly".

PARAGRAPH 8, Third sentence: This needs updating in the light of recent import figures. We suggest "considerably earlier" rather than "considerably more"; and add at end of sentence "in the middle of 1986, although this was reversed towards the end of 1986 and early in 1987".

PARAGRAPH 9, First sentence: Begin "Retail price inflation", delete "significantly"; add after "months" "in large part reflecting the movement of interest rates on housing loans, but also...."



PARAGRAPH 10: In general this needs updating in the light of the provisional outturn for the PSBR in financial year 1986-87.

First sentence: Insert "provisional" before "outturn"; redraft rest of sentence to read "...£3.3 b. ( $\frac{1}{2}$ -1 per cent of GDP), some £3 $\frac{1}{2}$  b. less than predicted....."

PARAGRAPH 11 Sixth sentence: This tells only part of the story on stamp duties. Rising prices of securities and houses are also important. The sentence could read "The sharp rise in stamp duties is attributable to rapidly expanding securities turnover and rising securities and house prices".

Seventh sentence: Insert "there was" before "considerable". Replace "education" with "local authority current spending" and delete from "among others" to the end of the sentence.

Penultimate sentence: Add after this a new sentence as follows "After allowing for drawings from the Reserve the planning total appears to have been overshoot by no more than  $\frac{1}{2}$  per cent".

Final sentence: Should begin "An improvement in the financial position of public corporations...." The existing draft may give a misleading impression of the effect of financial transactions by public corporations on the PSBR.

PARAGRAPH 12 Sixth sentence: Add at the beginning "Although falling unemployment may lessen pressure on social security spending".

Seventh and eighth sentences: Redraft as follows: "In particular public sector pay could grow more than implied by the Budget and it could prove difficult to contain this within existing cash limits. Some overshoot of the



planning total may again occur though not such as to reverse the downward trend in public spending as a proportion of GDP."

Ninth sentence: Detailed examination of the strong rise in government revenues recorded for financial year 1986-87 does not show this strong rise to be the result of "special factors" that will weaken. Most outside commentators share this view.

Tenth sentence: This is not drafted with precision. It uses the term "financial deficit" when it really means some measure of borrowing. The financial deficit is not affected by asset sales.

PARAGRAPH 13 First sentence: It is wrong to see any major change in emphasis within the MTFs framework. Successive versions of the MTFs have underlined the important role of the exchange rate in assessing monetary conditions. The aim remains to strike a balance between the exchange rate and domestic monetary growth consistent with the government's aim for money GDP and inflation.

Final sentence: After "satisfactory" continue "in present circumstances and that they would aim at broad exchange rate stability for the present".

PARAGRAPH 14 Fourth sentence, "there do not seem to us to be indications of a "steepening in the underlying trends" of bank lending for consumption". Noteworthy that the increase in private borrowing as a proportion of GDP is entirely accounted for by increased mortgage borrowing. (Between 1979-80 and 1986-87, private sector borrowing rose by 2.9 percentage points of GDP while mortgage borrowing rose by 3.4 percentage points over the same period.



PARAGRAPH 17 First sentence: Insert "continue" before decline.

Second sentence: This will clearly need to be redrafted in the light of revisions to the Secretariat's forecasts.

Third sentence: To describe the rise in wages as "unabated" is not justified in the light of recent information on private sector settlements.



Monetary Policy

Paragraph 1.2: It is misleading to suggest that £M3 has long been the linchpin of the medium-term financial strategy. Throughout the aim has been, rather, to create the monetary conditions consistent with steady downward pressure on inflation. At the time of the first MTFIS in 1980, the Green Paper on "Monetary Control" made it clear that the most appropriate monetary aggregates for target purposes could well change over time, as financial developments proceeded. Successive versions of the MTFIS have included target ranges for monetary aggregates other than £M3. In the 1987 version of the MTFIS, the Government decided that, given the rapid and pervasive changes in financial practices, it was no longer appropriate to have a formal target for broad money in 1987-88. In no sense can this be regarded as abandoning the linchpin of the strategy.

Paragraph 1.4 A number of other factors help to explain why short term interest rates in the United Kingdom are higher than in some other countries. In particular, the rapid progress made in dismantling direct controls of the financial markets has meant that interest rates alone have had to bear the weight of a monetary policy designed to place continuous downward pressure on inflation. In addition, demand for funds for investment purposes has been heavy.

Paragraph 1.9 In the United Kingdom at least, and probably more widely, it is not only portfolio shifts in financial markets that have affected the monetary aggregates. The clear trend towards deregulation of financial markets and the rapid pace of financial innovation have also been responsible.



## Fiscal Policy

Paragraph 1.17 Second sentence: It is not the case that the fiscal stance in the UK will be expansionary in 1987. The PSBR (as a share of GDP) will be close to the 1986-87 level. The debt/GDP ratio is likely to fall further (as noted in paragraph 1.19).



## UNITED KINGDOM

Assessment

1. The United Kingdom is enjoying continued expansion, with output growth in 1987 projected to exceed that for most other Member countries. While oil production, representing about 7 per cent of total output, continued to rise in 1986, the fall in oil prices has resulted in a switch in profitability towards energy-using companies and a substantial real income gain for consumers. Unlike many other countries, consumers have not only spent all of their windfall gains from lower energy prices but have also sharply increased their borrowing to finance further spending. Sterling support through high interest rates was discontinued in 1986, in view of the damping effect of oil prices on inflation. In the second half of the year export growth accelerated sharply, as previous losses in market shares were reversed, assisted by the depreciation of the pound sterling since mid-1985. At the same time, domestic demand was boosted by higher public expenditure on goods and services.

2. Despite overshooting of public spending targets and sharp falls in oil revenues, the rise in the general government deficit (national accounts definition), to about 3 per cent of GDP in 1986, was relatively modest thanks to buoyant non-oil tax receipts. The FY 1986/87 Public Sector Borrowing Requirement (PSBR) dropped to about 1 per cent of GDP, reflecting an increase in public asset sales corresponding to 1/2 per cent of GDP. The Medium Term Financial Strategy (MTFS), as set out in the March 1987 Budget, aims at maintaining the PSBR stable in relation to GDP, in spite of continuing reductions in taxation. Taking account of privatisation proceeds and the economic cycle, this points to a declining fiscal boost to the economy in the period ahead, provided that expenditure control can be improved. Economic policy continues to be set in a nominal framework with the intention of bringing down inflation by a gradual reduction in the growth of nominal GDP. However, target projections for the latter are now higher than those shown in last year's MTFS, reflecting the recent reacceleration of inflation. While recognising that a declining path for nominal GDP growth requires firm monetary policies, the authorities have dropped the formal target for broad money, due to increasing difficulties in interpreting its development. The narrow money target range for 1987 has been maintained; target ranges for the later years are intended to be gradually lowered in line with the projected path for nominal GDP growth. There has been a further step towards an exchange rate target: The 1987 MTFS refers to the G6 agreement of last February, and the authorities have indicated that they aim at a stabilisation of current exchange rates which they consider satisfactory.

3. On the basis of these policies and the technical assumptions of unchanged oil prices and exchange rates, the growth of activity is projected to decelerate in the period ahead, approaching that of potential output. In 1987, real GDP growth should exceed 3 per cent, with the revival of business investment following upon that of private consumption and exports. Unemployment is projected to drop somewhat for the first time since the beginning of the recovery in 1981. The fall in the unemployment rate, largely stemming from special employment measures so far, may increasingly reflect the sustained strength of the upturn. However, the acceleration of inflation and



**UNITED KINGDOM**  
**Demand, output and prices**

Percentage changes from previous period, seasonally adjusted at annual rates, volume (1980 prices)

	1982 current prices billion £	1984 1985 1986 1987 1988					1986		1987		1988	
		II	I	II	I	II	I	II	I	II		
Private consumption	167.4	2.1	3.7	4.7	3%	2%	5.1	3½	2%	2%	2%	
Government consumption	60.5	0.7	0.2	1.2	1½	1	3.9	¾	1	1	1	
Gross fixed investment	44.7	9.1	1.8	0.6	3	2%	0.2	4	3%	2%	2	
Public <sup>a</sup>	11.3	0.3	-14.4	1.9	-2½	-1%	-9.5	1	-1½	-1%	-1½	
Private residential	6.4	8.9	-3.0	13.2	5%	¾	27.7	-¾	0	¾	½	
Private non-residential	27.0	13.4	10.1	-2.6	4	4%	-2.2	6½	5%	4%	3%	
Final domestic demand	272.5	3.0	2.6	3.2	3%	2%	4.0	3	2½	2%	2%	
* change in stockbuilding	-1.3 <sup>b</sup>	-0.3	0.3	0	0	¼	-0.3	¼	¼	¼	0	
Total domestic demand	271.2	2.7	2.9	3.2	3%	2½	3.6	3%	2%	2½	2%	
Exports of goods and services	73.1	6.7	6.0	3.0	5%	3	11.2	4½	3%	3	3	
Imports of goods and services	68.1	9.2	3.1	5.8	7	4	18.1	3½	4	4	4	
* change in foreign balance	4.9 <sup>b</sup>	-0.6	0.8	-0.8	-¼	-¼	-1.7	¼	-¼	-¼	-¼	
* compromise adjustment	0.8 <sup>b</sup>	0.8	-0.2	0.3	½	0	1.6	0	0	0	0	
GDP at market prices <sup>c</sup>	277.0	2.9	3.5	2.7	3%	2%	3.5	3½	2%	2%	2	
GDP implicit price deflator	-	4.1	6.1	3.8	4%	5%	3.6	4½	5%	5%	5%	
<i>Memorandum items</i>												
Consumer prices <sup>d</sup>	-	4.8	5.3	3.7	4½	5	2.9	5¼	5%	5	4½	
Industrial production	-	3.9	3.1	0.2	3%	3	4.0	4	3%	3%	2½	
Unemployment rate	-	11.5	11.7	11.8	11½	11	11.8	11½	11¼	11¼	11	

\* As a percentage of GDP in the previous period.

a) Including nationalized industries and public corporations.

b) Actual amount of stockbuilding, foreign balance and compromise adjustment.

c) Data for GDP in the past are based on a compromise estimate which is the average of the expenditure, output and income estimates of GDP. The compromise adjustment is the difference between compromise GDP and the expenditure estimate of GDP.

d) National accounts implicit private consumption deflator.



the widening external deficit are worrying features of the projections, possibly calling the sustainability of the recovery into question.

4. The balance between real growth and inflation has tended to deteriorate with inflation likely to substantially exceed the OECD average in the foreseeable future. So far the reacceleration of inflation has mainly reflected the rise in import prices, which should slow down, under the technical assumption of constant exchange rates. Substantially more rapid wage increases than in other countries, however, are likely to remain a fundamental problem. The rise in unit labour costs, which decelerated recently, is very likely to pick up again when the cyclical acceleration of productivity growth is reversed. The resulting deterioration in international competitiveness is bound to affect export performance in the medium run, contributing to a continued widening of the external deficit. In the short run, the current account is likely to deteriorate due to the strong growth of imports associated with the consumer boom. Rising import penetration may be indicative of supply weaknesses.

5. In view of growing inflationary pressures and their implications for the external balance, the question arises whether policy should support an economy already in cyclical recovery. The authorities have repeatedly pointed out that rapid growth in the broad measure of money supply, and in particular in bank lending, remained a cause for concern but have allowed interest rates to fall, as the exchange rate tended to strengthen against the background of improving business confidence and rising oil prices. Another area of concern is public spending: given the expansionary effect of the tax reductions, a fall in the fiscal deficit consistent with a broadly neutral stance of policy would require tighter expenditure control than in the past.

#### Recent trends

6. Growth in the average measure of real GDP, which had dropped to an annual rate of 1 per cent in the final quarter of 1985, accelerated sharply in 1986, to reach an annual rate of 3 1/2 per cent by the end of the year, when the level of activity was about 17 per cent higher than at its cyclical trough in 1981. Taking 1986 as a whole, real GDP growth may have been a little more than 2 1/2 per cent (or 2 per cent if allowance is made for the direct effects of the 1985 coal dispute). Output of service industries increased by nearly 4 per cent, about the same as energy output, while output in manufacturing hardly rose, despite a marked revival of production later in the year.

7. Consumer spending was the main source of expenditure growth, supported by a strong rise in real incomes and a fall in the saving ratio assisted by abundant credit. Expenditure on durable goods grew by 9 per cent, twice as fast as total private consumption. Public consumption, which had declined in real terms during 1985, picked up markedly. Despite higher public investment and rapid growth in private residential investment, fixed capital formation almost stagnated in 1986, the weakest performance since 1981. This unexpected weakness reflected only in part the reduction of North Sea oil investment. Non-oil business investment, too, failed to recover, despite a further improvement in company profits (while total profits fell by 7 1/2 per cent, those of non-oil companies rose by 14 per cent). To some extent, weak investment performance can be explained by changes in taxation. The 1984



**UNITED KINGDOM**  
**Balance of payments**  
 Value, \$ million

	1985	1986	1987	1988	1985		1986		1987		1988	
					I	II	I	II	I	II	I	II
<i>Seasonally adjusted</i>												
Exports	100 161	106 792	121 250	129 750	47 428	52 732	52 996	53 796	59 500	61 500	63 750	66 000
Imports	102 870	118 892	141 750	152 000	49 047	53 822	57 100	61 792	69 500	72 250	74 750	77 250
Trade balance	-2 709	-12 100	-20 500	-22 250	-1 619	-1 090	-4 104	-7 996	-10 000	-10 500	-11 000	-11 250
Services and private transfers, net	11 585	13 866	16 250	16 750	5 407	6 179	5 909	7 957	8 250	8 000	8 250	8 500
Official transfers, net	-4 322	-3 378	-2 250	-2 250	-1 993	-2 329	-961	-2 417	-1 000	-1 000	-1 000	-1 000
Current balance	4 555	-1 612	-6 500	-7 750	1 795	2 760	844	-2 456	-2 750	-3 750	-4 000	-4 000
<i>Unadjusted</i>												
Current balance	4 555	-1 612			378	4 176	-479	-1 132				
Long-term capital	-19 257	-20 337			-11 071	-8 186	-11 122	-9 215				
Short-term capital and unrecorded	5 928	12 214			5 576	353	7 074	5 140				
Balance on non-monetary transactions	-8 775	-9 735			-5 117	-3 657	-4 527	-5 208				
Net transactions of monetary authorities <sup>a</sup>	162	4 301			483	-322	1 492	2 810				
<i>Memorandum items (Seasonally adjusted)</i>												
Per cent changes in volume <sup>b</sup>												
Exports	5.8	3.8	6.3	2.8	7.3	-3.0	2.8	12.9	4.9	2.8	2.7	2.9
Imports	3.4	7.4	8.7	4.0	0.4	0.2	2.8	24.9	1.9	4.2	4.0	4.0

Note: Detail may not add, due to rounding.

a) Previously *Balance on official settlements*. Foreign borrowing by the public sector is included in the capital account while changes in official sterling balances are included below the line as a financing item.

b) Over previous period at annual rates, customs basis.



corporate tax reform provided a strong inducement to accelerate investment programmes, and the recent weakness of manufacturing investment included a sharp fall in the contribution of leasing, following the abolition of first year allowances from April 1986. Stockbuilding fell in 1986 partly as a consequence of the strength of consumer demand.

8. Export growth accelerated sharply in the latter half of 1986 with export performance reacting relatively rapidly to exchange-rate-induced improvements in competitiveness. Exports of manufactures grew by 6 percentage points more than markets, largely recuperating the previous losses in market shares. Import growth showed a similar time pattern but accelerated considerably more than export growth (due in part to a less marked improvement in import price competitiveness) so that the real foreign balance acted as a drag on production. With the terms of trade deteriorating, due mainly to the oil price fall but partly also to the depreciation of the exchange rate, this led to a large swing in the current account into deficit. The non-oil external deficit changed little, however, in 1986, since the deterioration in the non-oil trade balance was largely offset by a higher invisible surplus, notably in net investment income.

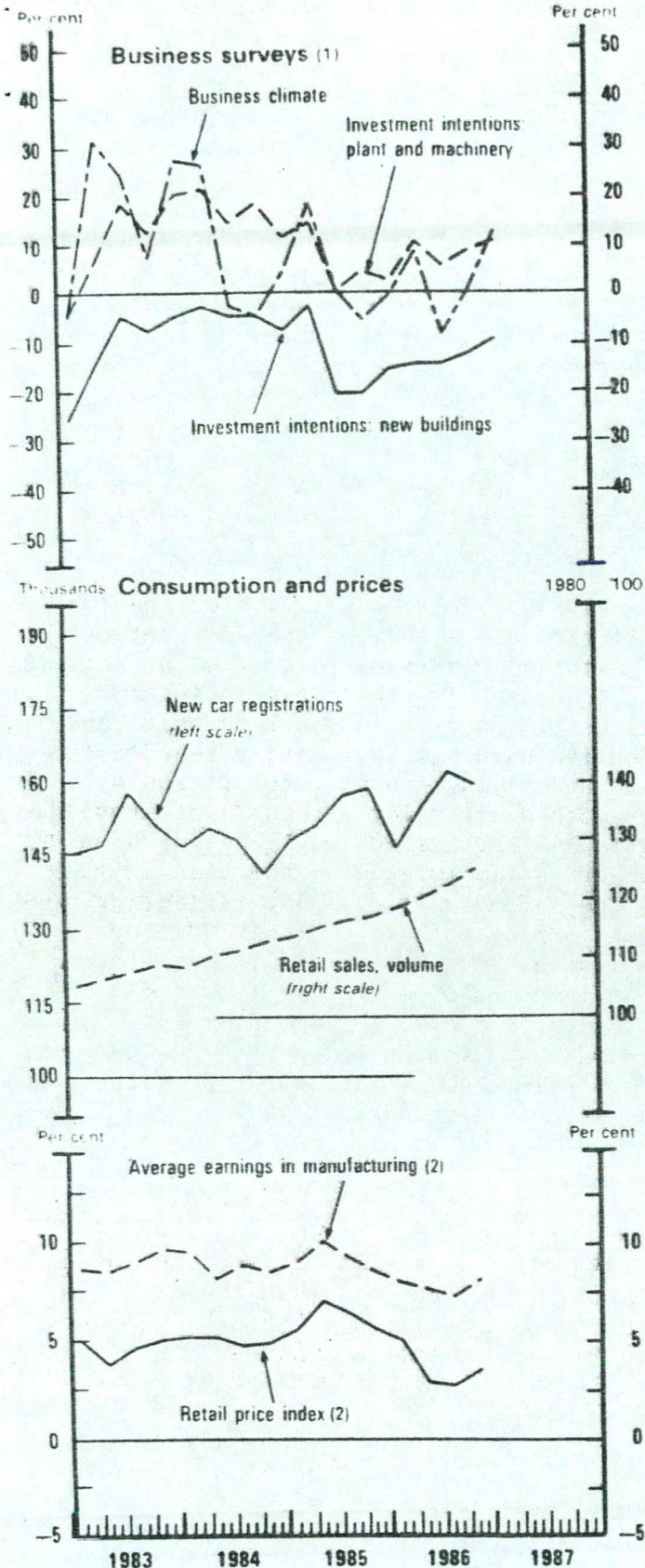
9. Inflation has picked up significantly in recent months, reflecting the reversed fall in import prices and little change in wage trends. Between mid-1986 and February 1987 industry's material and fuel costs rose by more than 4 per cent and the year-on-year increase in the retail price index accelerated from 2.4 per cent to 3.9 per cent. Despite indications that wage settlements have come down somewhat, effective earnings have hardly reacted to the fall in inflation in 1986. The underlying annual rate of growth of average earnings is estimated to have remained virtually unchanged at around 7 1/2 per cent since mid-1984, resulting in an increase in real wages of 4 per cent in 1986. In response to stronger activity growth, the rise in the employed labour force reaccelerated in the second half of 1986, reflecting a further increase in service industries' employment and a slower decline in manufacturing employment. With the growth in the total labour force apparently decelerating, the upward trend in unemployment since 1980 seems to have been reversed. In the six months to February, the unemployment rate (seasonally adjusted, excluding school leavers) fell by 1/2 percentage point to about 11 per cent of the working population. Part of the drop in unemployment reflected additional special employment measures.

### Policies

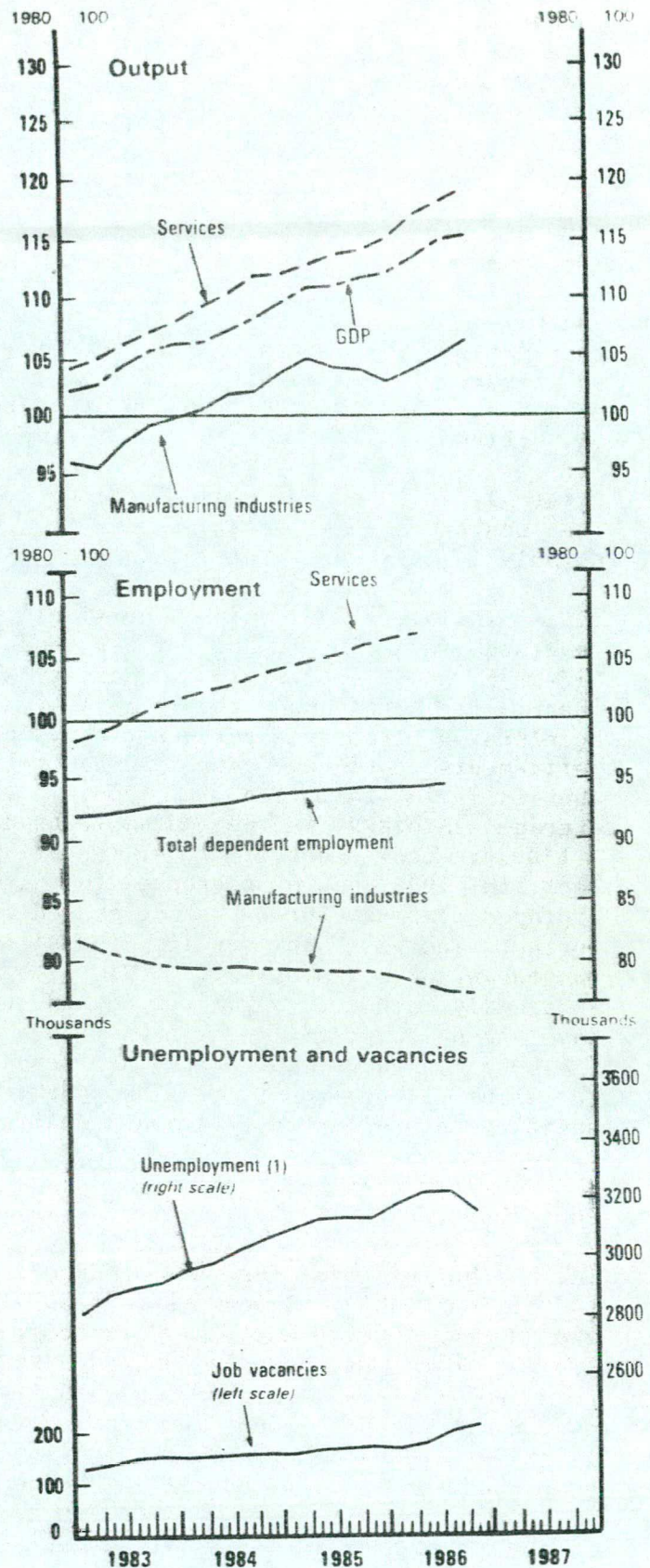
10. The outturn for the PSBR for 1986/87 is estimated to have been £4 billion (about 1 per cent of GDP), some £3 billion less than predicted in the March 1986 Budget. This compares with an outturn of £5.8 billion or 1.6 per cent of GDP in 1985/86. Excluding privatisation proceeds, the PSBR remained broadly unchanged at £8 1/2 billion. The 1986/87 PSBR (even excluding privatisation proceeds) is the lowest in relation to GDP since 1971/72. The March 1987 Budget projections are for an unchanged PSBR this year and next, with, however, considerably higher levels of both spending and revenues than envisaged in the 1986 MTFS. In the following years, the PSBR is projected to rise in nominal terms but to remain stable as a proportion of GDP.



**RECENT INDICATORS**



**OUTPUT AND LABOUR MARKET**



1. Balance between positive and negative answers  
2. Change over 4 quarters  
Sources: CBI, Economic Trends and Employment Gazette

1. United Kingdom, excluding school leavers  
Break in series in April 1983, recorded unemployment reduced by 160,000  
Sources: Economic Trends and Employment Gazette



11. The favourable outturn for 1986/87 was achieved in spite of a sharper-than-expected fall in oil revenues. Other tax revenues ran much higher than the 1986 Budget forecast, with non-North Sea corporation tax accounting for the bulk of the additional receipts. The reasons for this surge in corporate taxes are not clear, as the recorded rise in profits would seem to be insufficient to explain the outcome. One possibility is that the effect of the change in investment allowances resulting from the 1984 corporate tax reform has been significantly underestimated. The greater-than-expected buoyancy of indirect taxes reflects both stronger-than-forecast consumer spending and a change in the composition of consumption towards spending on goods and services subject to VAT. The sharp rise in stamp duties is attributable to rapidly expanding securities turnover. On the expenditure side, considerable overspending in the areas of social security and education, among others, was only partly offset by lower-than-projected debt interest payments. Public asset sales, which are counted as negative expenditure, appear to have almost met the projections, which were for a doubling of privatisation proceeds (to more than 1 per cent of GDP). Substantial debt repayments by public corporations also reduced the PSBR in 1986/87.

12. The March 1987 Budget decision to keep public borrowing at the level achieved in 1986/87 (and below the previous target) implies tax adjustments limited to about the amount foreshadowed in the 1986 MTFs; higher-than-expected revenues are to be used to finance extra expenditure. The Budget provides for tax reductions (beyond indexation) of £2 1/2 billion, mainly in the area of income tax. The basic rate of personal income tax is cut by 2 points to 27 per cent. Small companies' rate of corporation tax is reduced accordingly but the main corporate rate remains unchanged at 35 per cent. Spending plans are unchanged from those in the Autumn Statement and Public Expenditure White Paper, which raised the previous planning total by 3 per cent. Expenditure targets may, however, soon be put under pressure again, given past experience with expenditure control. In particular, public sector pay could grow more than implied by the Budget projections and inflation could be higher than assumed. Hence, the contingency reserve, which is lower than in 1986-87, may soon be exhausted. While the oil price assumption of \$15 per barrel is cautious, it might also be prudent to assume that the effects of the special factors which boosted revenues in FY 1986/87 will weaken. Thus, on balance, there seems to be a risk that the new PSBR targets may be overshoot and that, despite rising public asset sales, the financial deficit may not decline as projected. The Secretariat estimates for the general government financial deficit (including privatisation proceeds and other financial transactions) show a stabilisation in relation to GDP, following an increase from about 2 1/2 per cent in 1985 to some 3 per cent in 1986. This implies a continued rise in the cyclically-adjusted deficit in 1987, and little change in 1988 if public expenditure growth slows down as planned.

13. Within the framework of the MTFs, the emphasis has shifted away from monetary targetry, as more weight is given to the exchange rate. As noted, the broad money target has been suspended. The target range for narrow money (M0) growth in 1987 has been kept unchanged at 2 to 6 per cent, and a gradual reduction to a range of 0 to 4 per cent by 1990 is envisaged. Underlying growth of M0 significantly outside its target range would lead the authorities to change short-term interest rates, unless other indicators, including broad money and the exchange rate, suggest that monetary conditions remain satisfactory. The authorities have indicated that the present level of the

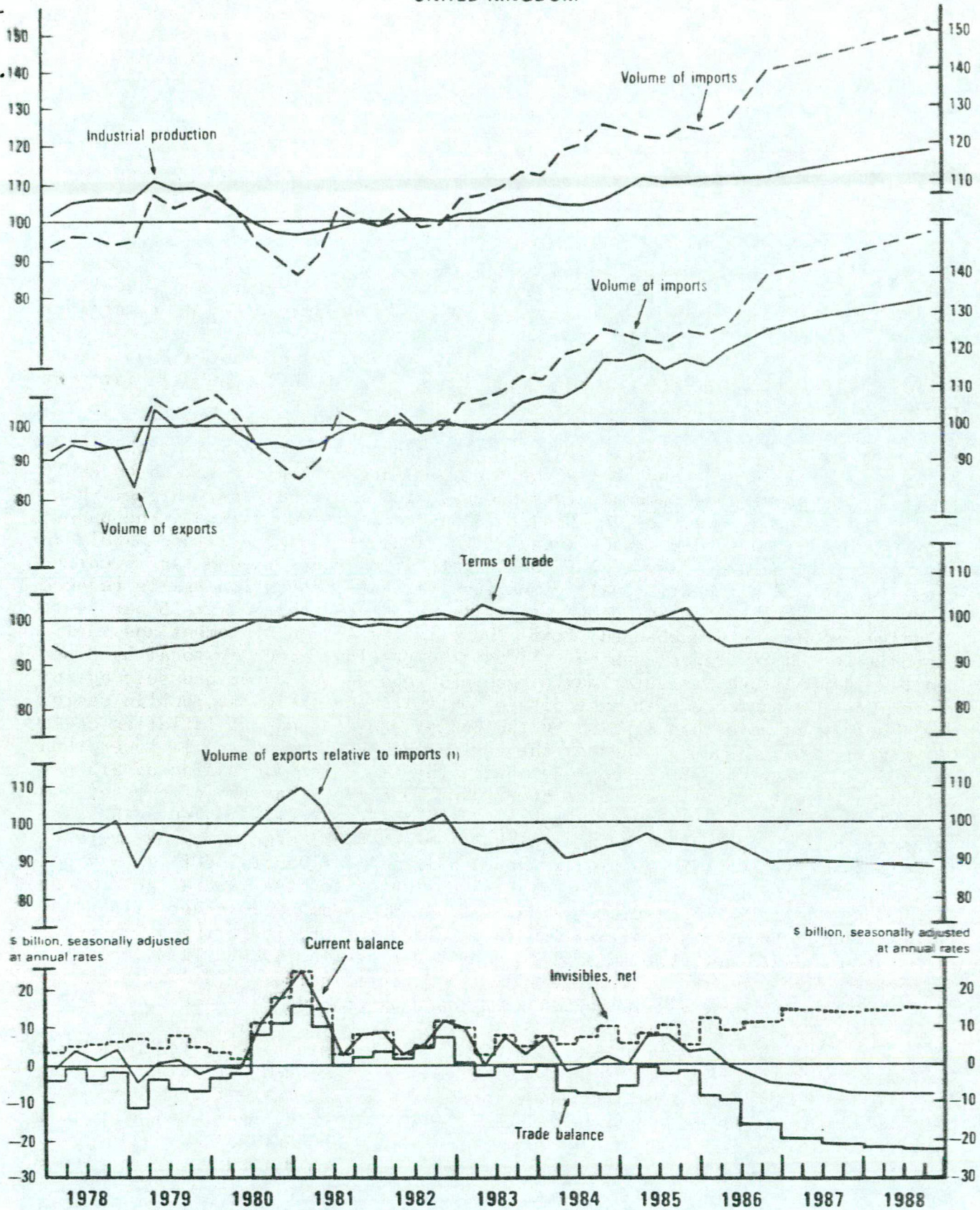


INDUSTRIAL OUTPUT, FOREIGN TRADE AND CURRENT BALANCE

UNITED KINGDOM

Indices 1982 100

Indices 1982 100



1. Ratio of export and import volume index multiplied by 100.  
Note: OECD forecasts from 1987 | onwards



exchange rate is satisfactory and that they would aim at exchange rate stability, co-operating closely with the other countries represented at the Louvre meeting of last February.

14. M0 growth edged up at the turn of the year but has fallen back towards the middle of its target range more recently. M3 has displayed an opposite pattern, moderating somewhat and picking up again thereafter; expanding by almost 19 per cent in the twelve months to February, it overshot the target range for the financial year 1986/87 by a wide margin. As the effect of strong bank lending on broad money growth was damped by substantial (temporary) overfunding in the early part of this year, M3 is probably still growing rapidly. Bank lending, in particular for consumption, has remained high and there are indications of a steepening in its underlying trend. After the disturbances, which led to higher interest rates in October, financial sentiment has gradually improved, reflecting developments in the oil market and the more favourable short-term outlook for the domestic economy. As a result, sterling was hardly affected by the turbulence in the foreign exchange markets early this year and has tended to appreciate recently. As the rapid growth in bank lending and the initially muted reaction of the exchange rate to the rising oil price might have suggested the need for some tightening of policy, the authorities adopted a cautious approach to cuts in interest rates but finally allowed them to fall. In March, banks' base rates were reduced in two steps to 10 per cent and are now back to the pre-October level.

#### Prospects

15. The present forecast is based on the assumption of unchanged oil prices and exchange rates as from February. Compared with Economic Outlook 40, the sterling effective exchange rate assumption is practically the same, while the oil price assumption is now higher (\$16 per barrel). Since the adoption of these assumptions, sterling has appreciated significantly; if not reversed, this would call for a modification of the projections. In line with policies described above, the fiscal stance is assumed to be expansionary, though to a diminishing degree, and interest rates to remain broadly unchanged, which would seem to be consistent with a gradual deceleration in monetary growth. After a marked improvement in the course of 1986, the competitive position is likely to deteriorate, as unit labour costs in the United Kingdom are projected to increase faster than abroad. Hence, export market gains are likely to decrease. Nevertheless, export growth is projected to remain broadly unchanged in the period ahead given that the growth of markets for manufactures is expected to accelerate -- from an annual rate of 3 per cent in the first half of 1987 to 5 1/2 per cent by the end of the projection period.

16. After the rapid expansion in the last eighteen months or so, growth in domestic demand is likely to slow somewhat when the projected revival of business investment and restocking no longer compensate for the deceleration in the expansion of private and public consumption. As noted above, private non-residential investment remained weak until the end of 1986. But intention surveys point to a marked pick-up early this year and into 1988. The capital/output ratio may now be relatively low, following a period of weak investment, and profitability and output expectations have further improved. However, the growth in business capital spending may decelerate towards the end of the projection period influenced by less buoyant export expectations



and lower profitability. Residential investment is projected to level off in the period ahead, given the deceleration in housing starts. Public investment should decline, according to Budget plans. Stockbuilding is expected to temporarily accelerate after the marked drop in the stock/output ratio last year. Budget plans point to slower growth in public consumption, following the rapid expansion in the recent period. Private consumption is also likely to grow at a slower pace. While rising inflation will erode personal income gains, the resulting weakening in consumer spending may be damped by some further decline in the saving ratio. Real GDP growth is projected broadly to follow the trend of domestic demand, though at a lower rate, as imports are forecast to continue to grow faster than exports.

17. Unemployment is expected to decline significantly for the first time in the 1980s, with its fall, however, likely to decelerate in the course of 1988. Inflation is projected to remain high by international comparison. The inflationary effect of import price increases should diminish, while the increase in unit labour costs is projected to reaccelerate, given the unabated rise in wages and the likely slowdown in productivity growth. All-in-all, some deceleration in inflation appears possible towards the end of the projection period. Given the forecast decline in real net exports, the current account deficit is expected to show a rising trend, although the turnaround in the terms-of-trade is likely to limit the extent of the deterioration in the external balance.



CES/87.24

Paris, drafted: 28th Apr 1987

dist: 29th Apr 1987

Or. Engl.

INFORMATION NOTE TO HEADS OF DELEGATION  
FROM THE SECRETARY-GENERAL

Arrangements for the Meeting of the Council at Ministerial level  
on 12th and 13th May 1987

I. DOCUMENTATION

1. The draft Agenda, C/MIN(87)1, and all the documents to which it refers have been distributed, with the exception of C/MIN(87)2(Final) which will be issued as soon as possible, and the draft Communiqué, a revised version of which is to be issued on 30th April for discussion by Heads of Delegation on 6th May.

II. PROCEDURAL ARRANGEMENTS

Meeting Room and Seating

2. The meeting will take place in Room 1 in the New Building, 19 rue de Franqueville. Attendance in Room 1 will be limited. As a general rule, each Delegation will have at least two seats at the table, it being understood that all Ministers and Representatives of Ministerial rank will be seated at the table. Up to three seats behind the table will be allocated to Delegations for each seat occupied at the table, the total to include the Permanent Representative. Each Delegation will receive more badges than seats to enable the participation to be changed according to the subject under discussion and to enable messengers to enter Room 1. Room 2 will serve as a listening room for Delegates for whom no seat is available in Room 1.

Should Ministers decide to meet in a restricted forum, i.e. accompanied by only one adviser, special badges will be issued for this purpose.

Timetable

3. The meeting will start at 9.30 p.m. on both days. Photographers and cameramen will be allowed into Room 1 from 9.30 a.m. to 9.35 a.m. on both days.

W 0110c

04306



### Documents

4. A file containing the Agenda and documents thereon for Ministers' consideration will be provided in Room 1 for each participant seated at the table. The relevant documentation listed at the end of the Agenda will be available in Room 1.

### Information

5. There will be a "Help Desk" in the hall outside Room 1 at which participants can obtain general information during the meeting.

### Statements by Ministers

6. The Secretariat understands that the Chairman of the meeting has written to Ministers about its organisation.

7. As explained to Heads of Delegation on 14th April, there will not be a formal speakers' list established in advance. Each item of the Agenda is to be introduced briefly by the Secretary-General. The Chairman may call on a few of his colleagues to help begin the discussion, but the basic method for conducting the debate will be for the Chairman to recognise requests to speak from around the table. Ministers who wish to speak should so indicate by placing their country name-plate in the vertical position and maintaining it there until they have the floor. The Chairman will recognise speakers in the order in which country name-plates have been raised. He will, however, give priority throughout the discussion to any Minister who wishes to make a very brief comment or to put a question on any statement which has just been made. (To attract the Chairman's attention for a "one minute" comment or question, the delegate should hold up his country's name-plate). Lastly, the Chairman will endeavour to take account of any Minister's need to speak at a specific time if, for example, the Minister in question must leave for another commitment.

8. Ministers who wish to have an extended version of their oral statement included in the record of the meeting should arrange for the written text to be passed to the Secretariat at a table provided for this purpose in the hall outside Room 1. Such statements will be reproduced immediately and, upon authorisation from the Delegation concerned, made available to participants and to the Press. The statements will be available in the Cinema [located next to Room 1].

9. If statements could be deposited with the Council Secretariat [Mme Lecoq, 80.55] in advance - i.e. on or before 11th May - this would alleviate the pressure on the reproduction services during the meeting itself. Such statements would not be made available to participants until authorisation had been given by the Delegation concerned.



### Working lunches for Ministers

10. Working lunches will be held in Room C of the Château de la Muette at 1.15 p.m. on both 12th and 13th May for representatives of Ministerial rank. The discussions will be led by the Chairman of the Ministerial meeting assisted by the Secretary-General. Permanent Delegations are requested to notify the External Relations Division [Mr. von Seidl-Zellbrugg, 80.69] as soon as possible, and no later than the day before each lunch, of the names of the representatives of Ministerial rank who will attend these working lunches.

11. Room Roger Ockrent and Room D will serve as listening rooms. A light lunch will be served in both rooms. Attendance in listening rooms will be limited to three representatives from each Delegation. Delegations are asked to provide the Council Secretariat (80.54) with the names of their representatives as soon as possible, and no later than the day preceding each working lunch. Entry badges will be available for these representatives in the Hall of the Château at the time of the lunches.

### Communiqué

12. Procedural flexibility will be required to deal with developments regarding the Communiqué. It is proposed, however, that during their working lunch on 12th May, Ministers should identify and discuss any specific problems of substance in the draft Communiqué in order to provide guidance for officials who will participate in a subsequent drafting group. It is not intended, however, that the lunch be devoted to detailed drafting.

13. At an appropriate moment following lunch on 12th May a Communiqué group will be called into session under the chairmanship of a Deputy Secretary-General. This group's function will be to seek drafting solutions for points of difficulty identified by the Ministers. It may begin its work in the afternoon of 12th May and continue into the evening as required. At an appropriate moment in the plenary discussions on 13th May Ministers will be informed of progress made by the Communiqué group. It is expected that Ministers will, if necessary, discuss any remaining problems concerning the Communiqué at their working lunch on 13th May. Depending on developments, the possibility of a restricted session of Ministers might also be envisaged following the lunch.

14. It would be appreciated if by Tuesday 5th May at the latest, each Delegation could inform the Secretariat [Mme de La Bouillierie, 80.57] of the name of an official (or officials if necessary) who will be responsible for negotiating/co-ordinating the Communiqué on behalf of the Delegation.

### Press Conference

15. A Press Conference (in Room 2) will be given by the Chairman, assisted by the Secretary-General, on 13th May at the end of the meeting.



### III. PRACTICAL ARRANGEMENTS

#### "Liaison officer" in Delegations

16. Delegations are requested to provide the Council Secretariat (80.54) with the name of a "Liaison officer" who can be contacted regarding various organisational aspects and practical arrangements. These officers are invited to attend a meeting in Room 4 on Monday 4th May, at 3.30 p.m., at which the Secretariat will review arrangements and answer any questions Delegations might have.

#### Composition of Delegations

17. Permanent Delegations are requested to notify the Council Secretariat of the composition of their Delegation. This should be done in writing as soon as possible, but no later than close of business on Tuesday, 5th May.

#### Interpretation

18. Simultaneous interpretation will be provided in Room 1 in English, French, German, Italian, Japanese and Turkish.

#### Secretariat facilities

19. Secretariat facilities - including English and French typists and a photocopy machine - will be available to Delegations requiring them in Room 4 of the New Building (opposite Room 1).

#### Press

20. Rooms 10 and 11 will be available to the Press, equipped with telephones and typewriters. Documents for the Press will be available in the Press rooms.

21. Rooms 7 and H.3 will be available for Press conferences and interviews which some Delegations may wish to hold. Delegates wishing to meet journalists during the meeting may request that the Secretariat make these rooms available for this purpose (Mr. Cohen, 75.59). The radio and television studios will also be available for broadcast interviews (Miss Townson, 80.97).

#### Security Area

22. The security area on the first sous-sol includes Rooms 1, 3, 4, 5 and 6, the adjacent Hall bounded by the communicating doors next to the lifts and the main stairs, and on the Rez-de-Cour Rooms 2 and 9 and offices C-50 to C-63. Accredited members of the Press will not be able to enter the security area (except for Room 2 at the time the Press Conference is held).



Control of Access

23. Entry badges for the Conference Room and the Listening Room will be sent to Delegations by the Council Secretariat prior to the meeting.

24. For Delegation and Secretariat staff who need to have access to the security area (security guards, secretaries, messengers), a written request stating the names of the persons concerned should be addressed to the Service de Sécurité, Unité administrative (Mme Balland, RCH 13 Pascal, 85.31) who will forward badges, as appropriate, to Delegations. However, it should be noted that only the badges issued by the Council Secretariat are valid for entry into Rooms 1 and 2.

Telephones and Telex

25. The telephone booths in the hall adjacent to Room 1 will be at the disposal of Delegates. The telephone number for incoming calls is 45 24 82 00.

26. The telex number of OECD is 620-160-OCDE-Paris and its telegraphic address is DEVELOPECONOMIE, PARIS, FRANCE.

Parking

27. A separate note has been issued on the entrance and parking of vehicles [SGD(87)12].

28. Delegations may use those parking places normally reserved for them in the Château grounds. Supplementary parking facilities will be available in the Rue de Franqueville (between the Place de Colombie and the Rue Dehodencq). Parking cards for this area will be issued by the Security Service prior to the meeting (Mme Balland, 85.31).

Enquiries

29. Enquiries regarding the meeting may be directed to Secretariat officers listed below:

- |                                                                              |    |                                           |
|------------------------------------------------------------------------------|----|-------------------------------------------|
| - Overall co-ordination                                                      | or | Mr. Myerson (80.20)<br>Mr. Harmel (80.50) |
| - Press relations                                                            |    | Mr. Rentschler (80.90)                    |
| - Protocol, luncheons and social activities<br>[see CES/87.25 and CES/87.26] |    | Mr. Monnier (80.60)                       |
| - Security                                                                   |    | Mr. Chervalier (83.03)                    |
| - List of participants and entry cards                                       |    | Mrs. Duboscq (80.54)                      |
| - Documentation for Ministerial dossiers                                     |    | Mme Jezic (80.56)                         |



Paris, drafted: 27th April 1987

dist:29th April 1987

Addendum 1 to :  
CES/87.25

Or. Fr.

INFORMATION NOTE TO HEADS OF DELEGATIONS  
FROM THE SECRETARY-GENERAL

Social events in connection with  
the Meeting of the Council at Ministerial level  
on 12th and 13th May 1987

Arrangements regarding the reception at the Elysée Palace on Tuesday, 12th May are as follows:

(a) For each national Delegation, personal invitations will be extended to the Minister(s), the Secretary or Secretaries of State members of Government participating in the Council Meeting, the Permanent Representative to the OECD, and one high-level official accompanying the Minister(s).

Delegations are requested to communicate orally to the External Relations Division (Extension 80.60 or 80.61), as soon as possible, the name of the high official to be invited.

(b) The reception will take place at 6.30 p.m. Arrival at the Elysée Palace is foreseen for 6.15 p.m. at the latest in order to permit all the guests to be in place prior to the President's arrival.

As on previous occasions, guests will go in their own cars to the Elysée Palace. A motorised police escort will await the cars at the exit of the New Building, where convoys of several cars will be formed. To ease the task of the French police, it would be appreciated if all available places in cars could be filled so as to involve as few cars as possible.

(c) The OECD Security Service will make the necessary arrangements with Delegations to facilitate the departure of cars for the Elysée Palace.



Paris, réd : 27 avril 1987

dist : 29 avril 1987

Addendum 1 au :  
CES/87.25

Or. fr.

NOTE D'INFORMATION DU SECRETAIRE GENERAL  
AUX CHEFS DE DELEGATIONS

Réceptions prévues à l'occasion de la réunion du Conseil  
au niveau des Ministres, qui se tiendra  
les 12 et 13 mai 1987

Les modalités de la réception qui sera donnée au Palais de l'Elysée le mardi 12 mai sont les suivantes :

(a) Des invitations personnelles seront adressées, pour chacune des Délégations nationales, au(x) Ministre(s), au(x) Secrétaire(s) d'Etat membres du Gouvernement, au Représentant Permanent auprès de l'OCDE, et à un haut fonctionnaire accompagnant le(s) Ministre(s).

Les Délégations sont priées de communiquer oralement à la Division des Relations Extérieures (poste 80.60 ou 80.61), aussitôt que possible, le nom du haut fonctionnaire concerné.

(b) La réception aura lieu à 18 heures 30. L'arrivée au Palais de l'Elysée est prévue pour 18 heures 15 au plus tard, afin que tous les invités puissent être placés avant l'arrivée du Président.

Comme à des occasions précédentes, les personnalités invitées se rendront à l'Elysée dans leurs voitures. Une escorte de policiers motocyclistes prendra en charge les voitures à la sortie du Nouveau Bâtiment, par convois de plusieurs voitures. Afin de faciliter la tâche des services de police français, il serait très apprécié que toutes les places disponibles soient occupées dans ces voitures, ce qui permettrait de réduire le plus possible le nombre de celles-ci.

(c) Le Service de Sécurité de l'OCDE prendra avec les Délégations les dispositions d'ordre pratique pour faciliter le départ des voitures vers le Palais de l'Elysée.



OECD  
AGENDA

CONFIDENTIAL

ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

CONFIDENTIAL

*PS / Chomellos  
B/F 6/5 p*

Paris, drafted: 28th April 1987  
dist.: 29th April 1987

CES/87.15  
(3rd revision)

Or. Engl.

INFORMATION NOTE TO HEADS OF DELEGATION  
FROM THE SECRETARY-GENERAL

Delegations will find attached a revised draft agenda for the Council at Ministerial level.

On 30th April, the Secretary-General will issue under his responsibility the draft agenda for the Council at Ministerial level.

CONFIDENTIAL

W1921c

04305



CONFIDENTIAL

ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

CONFIDENTIAL

Paris, drafted: 1987  
dist.: 1987  
C/MIN(87)1

Or. Engl.

COUNCIL  
AT MINISTERIAL LEVEL

Meeting to be held at the Château de la Muette, Paris  
on Tuesday 12th and Wednesday 13th May 1987, beginning at 9.30 a.m.

DRAFT AGENDA

1. ADOPTION OF THE AGENDA
2. TOWARDS BETTER ECONOMIC GROWTH IN  
THE CONTEXT OF GLOBAL INTERDEPENDENCE:  
PROSPECTS AND POLICIES C/MIN(87)2(Final)\*
3. AGRICULTURE: THE NECESSARY ADJUSTMENT  
  
Ministerial Mandate on Agricultural Trade C/MIN(87)4(Final)  
  
The problem of Agriculture C/MIN(87)5(Final)
4. A COMPREHENSIVE APPROACH TO  
STRUCTURAL ADJUSTMENT: THE ROLE  
OF TRADE AND OTHER POLICIES  
  
Structural Adjustment and  
Economic Performance: Synthesis Report C/MIN(87)3(Final)
5. DRAFT COMMUNIQUE C/MIN(87)6  
(1st Revision)
6. OTHER BUSINESS

\* This Note by the Secretary-General applies to Items 2 to 4 of the Agenda.

1921c

CONFIDENTIAL



CONFIDENTIAL

C/MIN(87)1

- 2 -

The following documents will also be made available to Ministers:

- Ministerial Mandate on  
Agricultural Trade Annexes I to VIII to  
C/MIN(87)4(Final)
- Trade in Services C/MIN(87)7(Final)
- Main developments in the field  
of Trade Policy C/MIN(87)8(Final)
- Strengthened transparency and  
discipline in the field of  
tied aid credits and  
associated financing of exports C/MIN(87)9(Final)
- Development Assistance Committee  
guiding principles for  
associated financing and tied  
and partially untied official  
development assistance C/MIN(87)10(Final)
- Structural Adjustment:  
Technical Report SG/ADJ(87)1 Chapters 1 to 10

CONFIDENTIAL



CONFIDENTIAL

ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

CONFIDENTIAL

Paris, drafted: 30th April 1987

dist: 30th April 1987

C/MIN(87)6(1st Revision)

Or. Eng/Fr.

COUNCIL  
AT MINISTERIAL LEVEL

DRAFT COMMUNIQUE

(Note by the Secretary-General)

Attached hereto is the draft Communiqué for consideration by  
Ministers.

CONFIDENTIAL

1147h

4373



DRAFT COMMUNIQUE

1. The Council of the OECD met on 12th and 13th May at Ministerial level. The meeting was chaired by Mr. Hans-Dietrich Genscher, Deputy Federal Chancellor and Federal Minister for Foreign Affairs and Dr. Martin Bangemann, Federal Minister of Economics, of the Federal Republic of Germany. The Vice-Chairmen were Mr Uffe Ellemann-Jensen, Minister of Foreign Affairs, and Mr Palle Simonsen, Minister of Finance, of Denmark; and Mr Roger Douglas, Minister of Finance of New Zealand.

I. IMPROVING GROWTH PROSPECTS

2. The economic strategy of the OECD countries has, over recent years, brought inflation down to its lowest level for a generation, at the same time maintaining positive growth rates. The long-term effort must be pursued, taking account of developments, in order to strengthen the prospects for stable and sustainable growth; to reduce progressively the levels of unemployment - unacceptably high almost everywhere; to correct the massive current account imbalances of the major countries; to consolidate the improvement in exchange rate configurations. The first and foremost contribution that the OECD countries can make to world prosperity is to foster vigorous economies in an open multilateral trading system.



3. In order to achieve these objectives, Ministers agree upon the following wide-ranging and mutually reinforcing actions. They are based on a common will to use to the full the possibilities of international co-operation and to exploit for the best the interactions between macro-economic and structural adjustment policies. Improved policies in both fields are interrelated elements in the strategy for stronger growth of output and employment. Both are essential. Macro-economic policies strengthen growth prospects, stabilise expectations and build confidence for the medium-term. Micro-economic policies create a more dynamic and responsive environment, in which growth and adjustment forces are stronger and macro-economic policies are more effective.

## II. MACRO-ECONOMIC POLICIES

4. Macro-economic policies must respond simultaneously to three needs: exploiting to the full the potential for non-inflationary, job-creating growth; maintaining medium-term orientations which contribute to the stability of expectations and building confidence; unwinding the present exceptionally large external imbalances of the major countries. International complementarity and compatibility of policies are essential in order that adjustment takes place in the perspective of growth and of greater exchange rate stability. Each country must make its contribution to the collective effort. In particular, the implementation of the commitments in the 'Louvre agreement', together with those in the recent communiqué of the Group of Seven countries, shall be achieved as rapidly as possible.



Member countries will reinforce their co-operation in this respect, continue to review the policy requirements of the situation and introduce further measures as necessary.

#### Monetary Policies

5. Monetary policies must remain geared towards growth of monetary aggregates and maintenance of financial market conditions consistent with low inflation objectives and real growth potential; they can also contribute to the orderly evolution of exchange rates. In view of the outlook for low inflation in many countries, a further market-led decline of interest rates in these countries -- in particular long-term rates -- could be helpful.

#### Fiscal Policies

6. Since the possibilities for monetary policy, by itself, to improve prospects are limited, these need to be enhanced by further action on the fiscal front.

7. In the United States, the process of reducing the Federal budget deficit -- which is coming down from 5.2% of GNP in 1986 to less than 4% in 1987 -- must and will continue in the years ahead. This course is essential for external and domestic reasons. The confidence of economic agents, in the United States and elsewhere, depends heavily upon it; so do, consequently, the prospects for moderate interest rates and stable exchange rates, sound economic



activity with an adequate flow of funds into productive investment, and resistance to protectionist temptations. These highly beneficial effects of reducing the Federal budget deficits should over time outweigh any short-term damping effect in the United States. Exchange rate changes have improved the cost competitiveness of US products and are having a positive effect on net exports.

8. Outside the United States demand weakness may be felt more strongly as exchange rate developments promote a shift in favour of American goods and services, both in the United States and elsewhere. This may prove particularly true for those countries with large external surpluses whose economic activity depends largely on exports and where it is essential, therefore, that domestic demand should grow more strongly than at present seems likely.

9. For Japan the objective is to achieve stronger growth with domestic demand increasing more rapidly than output, accompanied by a rapid growth in imports, consistent with the substantial terms of trade gains which have taken place. The Japanese authorities can and will take further substantial fiscal and other measures to strengthen the growth of domestic demand without prejudicing medium-term objectives which were designed to rectify the unsound fiscal position of the central government. In this regard, it is to be noted that the recent Japanese initiative to expand domestic demand is part of the far-reaching longer-term effort to reorient the Japanese economy.



10. In Germany, also, the growth of domestic demand, and particularly of private investment, must be sustained and exceed substantially the growth of output. In order to support growth and external adjustment, the German government has already announced that some scheduled tax cuts will be accelerated to 1st January 1988 and a broader tax reform will be implemented in 1990. This will have a favourable influence on investment. In addition, further measures of structural adjustment, including reduction of subsidies, will be implemented. Taken together, these actions will contribute to an increase of the general budget deficit relative to GNP between now and 1990. Fiscal prudence over recent years permits this kind of action.

11. Other countries with substantial current account surpluses should also take appropriate action to encourage domestic demand growth relative to sustainable output.

12. Some countries face tight constraints insofar as fiscal policy is concerned. For those countries which have large budget deficits, priority must continue to be given to correcting them. There are a few countries in Europe, however, where budget deficits are not large but where the balance of payments imposes a constraint. These countries would be able to undertake some fiscal actions to bolster growth, if demand strengthened in their major trading partners. In this latter respect, and as an example, a co-operative economic strategy of the EEC countries could take advantage of their interdependence and be accompanied by other European countries.



III. STRUCTURAL ADJUSTMENT POLICIES

13. Ministers welcome the Report on Structural Adjustment and Economic Performance. Despite progress in recent years, OECD economies are still hampered by major distortions and rigidities. These compound current macro-economic problems and retard growth. Increasing competition in product markets, responsiveness in factor markets and effectiveness in the public sector will contribute significantly to growth potential in all countries. Priorities in reforming structural policies will vary in individual countries reflecting differing national situations but also international requirements. It is thus essential that concerted action be guided by common principles. To ensure the greatest gains from reform, action must be broad, bold and sustained. The effects of such action will emerge mainly in the medium term. Implementation now, by expanding opportunities and bolstering confidence about the future, will underpin present efforts to strengthen non-inflationary growth and to reduce unemployment. Successful structural adjustment can simultaneously increase fairness and offer improving opportunities for all. Increasing social dialogue is an integral part of this process.

14. The conclusions drawn by the Economic Policy Committee on the Report on Structural Adjustment were endorsed and will guide action in the forthcoming years. The Secretary-General is requested to report, at appropriate intervals, on the work of the Organisation on macro-economic and structural issues at subsequent meetings of the Council at Ministerial Level.



Trade Policies

15. International trade provides, through competition, the most powerful means of promoting economic efficiency. Measures which impede or distort the functioning of international markets tend to preserve outdated economic structures, damage consumer interests, weaken incentives for investment and thus restrain economic growth. Therefore, it is of paramount importance to reverse recent trends towards restrictive trade measures, notably of a bilateral or a discriminatory nature, and to act with determination to strengthen and extend the open multilateral trading system. The OECD must intensify its monitoring of the various aspects of trade policies.

16. The Uruguay Round, which comprehensively covers all the subjects of relevance to trade, presents a unique opportunity to create an improved framework for trade in the 1990s and beyond. OECD countries will work for sustained and substantive progress in the negotiations towards a balanced global result which would be of benefit to all, developed and developing countries alike. Early submission of negotiating proposals by OECD countries will prove their resolve, as will the carrying out of the standstill and rollback commitments they have entered into and their opposition to domestic protectionist pressures. Wherever possible, early implementation of partial results of the negotiations in certain fields will be sought, along the lines of the Punta del Este Declaration.



17. There has been welcome progress in the Organisation's work on trade in services. This is of particular importance in the light both of the inclusion of services in the Uruguay Round and of the continuing efforts to strengthen the OECD Codes of Liberalisation of Invisible Operations and of Capital Movements. Work in the services area will be actively pursued.

18. Ministers welcome the agreement recently reached by the Participants in the Arrangement on Guidelines for Officially Supported Export Credits in response to directives from the 1984 and 1985 Ministerial Councils of the OECD. The agreement will strengthen substantially the Arrangement and reduce the risk of trade and aid distortions. Ministers also welcomed the recent agreement on the related DAC guiding principles. These are a tangible sign of co-operation in a difficult period.

#### Agriculture

19. The joint report of the Trade and Agriculture Committees [C/MIN(87)4 Final] was approved. This important work clearly highlights the serious imbalances that prevail in the markets for the main agricultural products. Boosted by policies which have prevented an adequate transmission of market signals to farmers, supply substantially exceeds effective demand. The cost of agricultural policies is considerable, for government budgets, for consumers and for the economy as a whole. Moreover, excessive support policies entail an increasing distortion of competition on world markets; run counter to the principle of comparative advantage



which is at the root of international trade; and severely damage the situation of many developing countries. This steady deterioration, compounded by technological change and other factors such as slow economic growth or wide exchange rate changes, creates serious difficulties in international trade, which risk going beyond the bounds of agricultural trade alone.

20. This deterioration must be halted. Some countries, or groups of countries, have begun to work in this direction. But, given the scope of the problems and their urgency, and given the shared responsibilities of all countries in the present situation, a concerted reform of agricultural policies will be implemented.

21. Reform will be based on the following principles:

- a. The long-term objective is to allow market signals to determine, more directly and more freely, by way of progressive reduction of agricultural support, the orientation of agricultural production; this will bring about a better allocation of resources which will benefit consumers and the economy in general.
- b. Agricultural policies take into consideration social and other concerns, such as food security or environment protection, which are not purely economic. The progressive correction of policies to achieve the



long-term objective will thus require time; it is all the more necessary that this correction be started without delay.

c. The most pressing need is to avoid further deterioration of present market imbalances. It is necessary:

- on the demand side, to improve prospects as much as possible inside as well as outside the OECD area;
- on the supply side, to implement measures which, by reducing guaranteed prices and other types of production incentives, by imposing quantitative restrictions, or by any other means, will prevent an increase in excess supply. When support linked to production is granted to farmers, it should be set within specific limits.

d. When quotas are imposed or productive farming resources withdrawn by administrative decision, these steps should be taken in such a way as to minimise possible economic distortions and should be conceived and implemented in such a way as to permit better functioning of market mechanisms.

e. Rather than being provided exclusively through price guarantees or other measures linked to production or to



factors of production, farm income support should increasingly be sought through direct income support designed to meet the needs of low-income farmers or those in particularly disadvantaged regions.

f. The adjustment of the agricultural sector will be facilitated if it is supported by comprehensive policies for the development of various activities in rural areas. Farmers and their families will thus be helped to find supplementary or alternative income.

g. In implementing the above principles Governments should have some flexibility in the choice of the means necessary for the fulfilment of their commitments.

22. The Uruguay Round is of decisive importance for agricultural reform. It will provide the framework for most of the necessary measures, especially with regard to a progressive reduction of assistance to and protection of agriculture on a multi-country and multi-commodity basis. Expeditious and comprehensive implementation of these negotiations based on the Ministerial Declaration of Punta del Este will be pursued vigorously and comprehensive negotiating proposals will be tabled by OECD Governments over the coming months.

23. In order to permit a de-escalation of present tensions and thereby enhance prospects for the earliest possible progress in the



Uruguay Round as a whole, OECD governments will carry out expeditiously their standstill and rollback commitments and, more generally, refrain from actions which would worsen the negotiating climate. They will, inter alia, avoid actions which would result in stimulating production in surplus agricultural commodities, in isolating the domestic market further from international markets, in pursuing aggressive trade practices, or in disruptive disposal of surplus stocks.

24. Agricultural reform is not solely in the interests of Member countries. Developing countries which are agricultural exporters will benefit from a recovery on world markets. Developing countries which are importers of agricultural produce will be encouraged to base their economic development on more solid ground, by strengthening their own farm sector.

25. Agricultural reform poses vast and difficult problems for Member countries. Strengthened international co-operation is needed to overcome these problems. The OECD will continue to contribute to their solution by deepening further its work; by improving the analytical tools it has begun to develop and which will prove particularly valuable in many respects; by monitoring the implementation of the various actions and principles listed above. The Secretary-General is asked to submit a progress report to the Council at Ministerial level in 1988.



Financial Markets

26. The process of liberalisation in financial markets and financial institutions must continue. Alongside the clear benefits deriving from this process, new forms of regulation and supervision are needed to ensure the viability and stability of markets. Increased compatibility and convergence of policies must be achieved regarding prudential supervision of these markets. The Organisation will intensify its efforts to promote such co-operation.

Tax Reform

27. Most OECD countries have undertaken or are considering major tax reforms. Well-constructed tax reform can considerably enhance performance at both macro and micro-economic levels. Tax reform should focus on simplicity, equity and providing incentives to work, save and invest. The competent bodies of the Organisation will actively contribute to reflection on tax reforms in Member countries and consider the best means of achieving them in an internationally consistent manner.

Technological Change

28. The development and diffusion of technology is central to the growth of output, employment and living standards. The process of technological change provides opportunities that must be grasped. Much work has already been done within the Organisation on analysing



and interpreting various elements of this process. Ministers welcome the Secretary-General's intention to develop rapidly an overall programme of work to deepen the analysis in order to understand better, and make better use of, technological advances. A progress report will be made to Ministers at their meeting in 1988.

#### Employment and Socio-Economic Reform

29. Structural changes in national economies both influence and are influenced by social attitudes and conditions. In view of the seriousness of unemployment problems in most countries, three areas of socio-economic reform are particularly important - all involve, in varying degrees, the private sector and the social partners as well as governments. First, there is a pressing need in many countries to improve the quality of education and training systems, and to adapt them more to the needs of societies and economies undergoing rapid structural change. Second, more flexible labour markets are needed to facilitate access to the new jobs emerging as structural and technical change accelerates. Third, social protection needs to evolve so that displaced and unemployed people are given not only income support, but also, especially through training, opportunities and incentives to get back into work or other useful activities such as local employment initiatives. OECD work in these areas will be intensified, a key aim being to prepare a new framework for labour market policies as agreed at the meeting of the Manpower and Social Affairs Committee at Ministerial level in November 1986.



Environment

30. There is general agreement that environmental concerns have to be given a high priority in government policies, in order to safeguard and improve the quality of life as well as to preserve the resource base needed for sustained economic development. Member countries will develop, within OECD, approaches and methods for more systematically and effectively incorporating environmental considerations into the policy-making process. Work will be intensified on policies needed to prevent more effectively the release of hazardous substances to the environment, including from large-scale accidents.

Energy

31. The past year has seen a dramatic fall and fluctuations in the price of oil and significant falls in the prices of coal and gas. While lower energy prices have wider economic advantages, they may tend to increase consumption and reduce indigenous production of energy. The Chernobyl reactor accident has called greater attention to the safety aspects of nuclear power. These developments could intensify the tightening of energy markets, already expected for the 1990s. It is necessary to develop energy policies in such a way as to minimise the risks to which low energy prices give rise, while continuing to secure their general benefits for the world economy. The Governing Board of the International Energy Agency, meeting at Ministerial level on 11th May 1987, took decisions designed to



strengthen existing policies in a number of areas including indigenous energy production, the efficient use of energy, diversification of the sources of primary energy used in the generation of electricity and measures to respond to an interruption in oil supplies.

#### IV. RELATIONS WITH DEVELOPING COUNTRIES

32. In a world characterised by an increasing level of interdependence, the economic problems and performance of developing countries have become increasingly diverse. While a number of developing countries, particularly in Asia, have made significant progress, many others have suffered economic setbacks in recent years, contributing to the weakening of growth worldwide. Economic co-operation with developing countries must respond to varying capacities and needs in the critical areas of trade, debt and finance. Developed countries must strive to ensure a better environment for developing countries' growth and exports. In this regard, the implementation of the policy directions and objectives set out in this communiqué will represent a significant contribution by OECD countries to better global prospects.

33. Economic policies in developing countries themselves will remain a major factor in their own performance. Upon them depend heavily confidence, savings and investment, both domestic and foreign. The wide range of developing countries presently implementing resolute economic policy reforms to establish a sound



development process must be supported and encouraged by all possible means including official development assistance. Those developing countries whose economic strength is already significant should progressively play their full part in the rights and obligations of the multilateral trading system.

34. Large debt burdens remain a major impediment to growth in heavily indebted middle-income countries, despite some important achievements in implementing the growth-oriented approach to the resolution of debt problems, it is clear that, in some cases, adjustment and financing processes are not working satisfactorily and the risk of damaging disruption cannot be discounted. Enhanced co-operative action by all parties involved -- debtor and creditor governments, the international financial institutions and private banks -- is the only way in which the strains can be managed in a growth-promoting environment. The trend towards innovative and more flexible approaches on the financing side, both private and official, should play a key role in making debt burdens more manageable and restoring capital flows.

35. Debt problems also prevail among low-income countries especially in sub-Saharan Africa. Proposals have recently been made by OECD countries for additional action to alleviate the debt burden of the poorest countries undertaking strong growth-oriented adjustment programmes. Early results from the current discussions among creditor governments would be welcomed.



36. For poorer developing countries, provision of adequate concessional finance is essential. OECD countries' record in this respect is already substantial. The volume and forms of aid must be commensurate with the growing requirements of policy reform programmes and broader development efforts. The new DAC guiding principles for using aid to support improved development policies and programmes and strengthening aid co-ordination with developing countries are welcomed.

37. Commodity-dependent developing countries face difficult problems in view of the outlook for many commodities. New efforts should be made to develop forms of co-operation directed at the structural and development dimensions of commodity dependence. Action to remove measures distorting trade in commodities will make an important contribution to export prospects for commodity-dependent developing countries.

38. UNCTAD VII provides a welcome opportunity to discuss with developing countries the major problems and policy issues in the global economy -- structural change, national policies, macro-economic interdependence, trade, commodities and resource flows -- with a view to arriving at common perceptions and constructive solutions.



CONFIDENTIAL

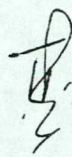
FROM: SIR T BURNS  
DATE: 1 MAY 1987

CHANCELLOR

*V. 2  
A. Good  
Thank you  
Mr. S. J. &  
Mr. J. J. &  
Mr. J. J. &*

cc Sir P Middleton  
Sir G Littler  
Mr Cassell  
Mr Lavelle  
Mr Evans  
Mr Odling-Smee  
Mr Sedgwick  
Mr Culpin  
Mr S Matthews

I attach a copy of the remarks I made yesterday to EPC.



T BURNS

ENC



REMARKS TO EPC 30 APRIL 1987

Chairman

1. It has been a moderately depressing discussion. A lot of hand-wringing; a lot of frustration; a lot of anxiety, and a lot of puzzlement - as one delegate remarked "the world refuses to work in the way members of EPC think it should".

2. In my own mind I have tried to separate the worries. Although clearly interrelated there seem to be four strands of concern:

(i) overall performance of the major industrial economies has been disappointing in 1986 and is forecast to remain so over the next two years. This is despite the fall in oil prices and the dollar - both events which it was hoped would help sustain the recovery;

(ii) the persistence of current account imbalances and projections that they will continue into the medium term. This is combined with a fear that the three largest countries are not prepared to take the necessary policy actions to reduce those imbalances;

(iii) the fear that governments will do foolish things. The most obvious threat is increased protection. But there are also fears that the pressures of financial markets might provoke policy responses that could threaten recovery;

(iv) the fear that financial markets will do foolish things. We have seen huge movements in foreign exchange markets. Many of those who could never understand why the dollar rose to such dizzy heights fear we might see equally excessive dollar depreciation. Many worry that such an undershoot could cause inflation problems for the US and industrial problems for Germany and Japan.



3. Like to comment on each of these worries.

Disappointing Overall Performance

4. Is there a problem with overall performance? A year ago many forecasters were looking to 3 per cent growth for the OECD in 1986 followed by 3 per cent plus in 1987. Now we are looking at 2½ per cent forecasts in 1986 to 1988. But whilst this may be disappointing it cannot be described as alarming; it would be a mistake to exaggerate the differences.

5. Of course, performance seems worse when we consider that fall in oil prices and correction of dollar were, if anything, expected to help. My own view is that, if anything, macro economic policy in aggregate in the main industrialised countries has remained a little on the tight side. As a result more of the gains have been taken in lower inflation, and less in the form of activity. And by contrast with some of the views expressed here I would point to monetary policy rather than fiscal policy. Despite the growth of monetary aggregates real interest rates have remained high; and commodity prices, having fallen sharply during 1986, have shown little recovery.

6. Even so I would not put much emphasis on the aggregate macro-stance for disappointing growth. The bulk of the problem seems to be the difficulties of adjusting to the large real price changes; oil prices, commodity prices, and currencies. In time these transitional problems should sort themselves out and I resist suggestions that we should respond by efforts to fine tune a policy response. The main lesson seems to be that large real price changes are damaging - in either direction, up or down.

7. So in aggregate I doubt if we need a major change to the overall approach; steadily disinflationary policy combined with policies to improve supply performance orientated towards the medium term remain the best combination on offer.

*My  
Interview  
Notes!  
(x correct)*



Disappointing Current Account Imbalances

8. Persistent current account imbalances and differences in performance between countries are more of a problem; largely because no-one seems to like them, markets, politicians, or voters.

9. I have argued here before that correction will take time. The imbalances built up over many years. During the five years or so of the dollar rise US domestic demand grew by 1 per cent per annum more than GDP. In Germany and Japan we had the mirror image. It will take time to unwind that process - several years of cumulative significant differences between domestic demand and GDP growth. Meanwhile we live with the familiar and predictable problems of the J-curve.

10. I think I am more optimistic than many that we will see some correction over the medium-term if we persist with present policies. The effects of exchange rate changes will build up to substantial effects.

11. But credibility will be helped if countries concerned are seen to be taking effective action. Many of the worries expressed here reflect a worry that despite all promises the US is not taking enough action on the budget. And each time we hear of a fudge on the arithmetic; a projection that is not delivered; and an explanation of why the twin deficits are unrelated, confidence is damaged.

12. There is also a worry that Japan and Germany are not sufficiently ambitious about the growth of domestic demand; and in the case of Japan that they are not prepared to open markets fast enough. I hope delegates will forgive me if I say that the Q and A sessions we had yesterday have not removed those worries. Personally I accept assurances that action is now being taken. It needs to be sustained.

13. I have an additional observation. Several comments have been made that recent exchange rate changes are taking longer than



expected to show results. Our own experience over the past 20 years has been that when exchange rate changes seem to be slow in having their effect on current account balances it is usually because other policies are not being sufficiently supportive of the exchange rate adjustment.

Worry that countries will do foolish things

14. Undoubtedly much of the worry is not with the unchanged policy, unchanged exchange rate projections presented by the Secretariat. But the fear of the implications of policy adjustments and exchange rate changes. There is considerable alarm about protectionist threats to the US.

✓ 15. There is also a lot of resentment. In many people's view the current account imbalances are primarily the responsibility of the US. They pursued fiscal policy that was quite the opposite of the consensus. They not only watched the dollar rise but encouraged and applauded it. This dollar appreciation put pressures on other countries whose economies became more export orientated. Germany and Japan took advantage of these circumstances to reduce budget deficits, further encouraged by the high interest rates they faced.

16. It is now not good enough for the US to throw all the blame on the surplus countries. At the same time surplus countries need to recognise that they have experienced very low domestic demand growth in the first half of the 1980s. They have a lot of ground to make up. They adjusted policy in the face of the rising dollar and must now respond to the dollar fall.

Worries that markets will do the wrong things?

17. Finally there is a lot of worry that markets will do the wrong things. They worry that we now face the serious danger of exchange rates overshooting in the other direction.



CONFIDENTIAL

18. I feel we have to face the reality that the international monetary system has great difficulty in dealing with significant differences in the policy stance of member countries. The swings in exchange rates have been much bigger than many of us expected when the world embarked on floating exchange rates. These unpredictable swings in real exchange rates in turn have damaged performance of industrial countries.

19. One lesson is that we need greater policy compatibility. There is much truth in this. But it is difficult to be optimistic. Significant differences between countries in the framework being used have been revealed during these meetings. And even small differences can be quickly amplified by exchange rate movements.

20. The desire for greater exchange rate stability has been clearly shown in the Louvre agreement and the Washington discussions. But we have also seen that achieving it is far from simple.

21. If we will the ends we must will the means. Some countries, like the UK, have been trying for many years to take exchange rates into account in assessing monetary conditions. If we are to have greater exchange rate stability even the largest countries have to give an explicit weight to exchange rates in decisions about monetary policy. This also means giving less weight to domestic indicators. If we want to have greater exchange rate stability it has to be turned into suitable action. It won't be easy but minds have to be focussed on this challenge. Some of the unease round the table and in financial markets relates to worries that although the G3 say they want greater exchange rate stability there is some doubt about whether they are willing to take the necessary action.

22. Of course if industrial countries are to give greater weight to exchange rates then we must ensure that does not lead to an inflationary or deflationary bias for the G7 as a whole. This requires concentration upon behaviour of G7 in aggregate and a continuing assessment of their position in aggregate. It means



\* monitoring global monetary behaviour, aggregate activity and inflation and aggregate monetary conditions generally. For example, only then can we tell whether differential movements of interest rates should be brought about by some rates rising or some falling or some combination of both.

✓ 23. We have reached the stage where there is increasing agreement about objectives; the next step is to be prepared to take the necessary action.



CHANCELLOR

Ch  
 But on SSA debt  
 (para 35) is v feeble.  
 Surely we should go for  
 a strong endorsement of  
 your proposals?  
 AA

FROM: S W MATTHEWS

DATE: 1 MAY 1987

cc: Sir P Middleton  
 Sir T Burns  
 Sir G Littler  
 Mr Byatt  
 Mr Evans  
 Mr Mountfield  
 Mr Culpin  
 Miss O'Mara.

MS26.  
 I have also  
 made a  
 few  
 marginal  
 comments.

## OECD MINISTERIAL MEETING: COMMUNIQUE

You are planning to attend the OECD Ministerial Meeting on 12 May. Mr Evans will be circulating briefing and draft speaking notes on 6 May and your office has arranged a briefing meeting for 7 May.

2. Meanwhile, you may like to glance at the draft communique, which is attached. The OECD are hoping to reduce the amount of time spent at the Ministerial on communique drafting and want to get as much as possible of the language settled before the meeting. Our Ambassador at the OECD, Mr Bayne, and the other Ambassadors will be meeting to try to do this on 6 May. Past experience suggests that this will be a vain effort, but we nevertheless need to brief Mr Bayne on the line he should take.

3. We have commented on an earlier draft of the communique and the present draft is a definite improvement. The Economic Policy Committee yesterday looked at paragraphs 2 to 14 and Sir Peter Middleton considered that we could on balance live with the current draft of these paragraphs (this' that's what he said about the Commission's annual economic report)

4. Issues in the communique where it is particularly important that the OECD Ministerial should set the right tone for the Venice Summit and subsequent international meetings include:

- Japan: paragraph 9 is unspecific about the scale of the additional fiscal measures and the structural or supply-side measures which Japan is to take.
- Agriculture: the Germans (who are chairing the OECD Ministerial) and others may seek to weaken the references in paragraphs 19 to 25 to reducing agricultural support, weak as these are already (c.f paragraph 21.c which speaks of "preventing an increase in" rather than "reducing" excess supply).



- Developing countries and debt: paragraphs 32 to 38.

5. It would be most helpful to have your reactions to the communique by 10am on Tuesday 5 May so that we can pass them on to Mr Bayne.

SM.

S W MATTHEWS



From : H P Evans  
Date : 1 May 1987

MR MATTHEWS

cc Mr Dolphin  
Mr Savage  
Mr Hudson  
Ms Symes  
Mr Redley

**OECD MINISTERIAL**

With help from Ms Symes, I have put together the attached draft speaking note.

2. Could I please have comments by close on Tuesday, 5 May. The FCO and others can see it when it goes to the Chancellor on 6 May, though if they are pressing it will do little harm (or good) to show them this.

*Y. Engledow* (ps)  
p.p. HOW EVANS



## OECD MINISTERIAL : SPEAKING NOTES FOR CHANCELLOR'S INTERVENTION

### Macro-Economic Prospects and Policies

The last year has been disappointing for the world economy. In retrospect, we did not allow enough for the difficulties caused by some very large changes in relative prices : commodity prices and exchange rates. Those whose incomes fell reacted more quickly than those whose incomes rose.

2. This time last year, OECD staff were looking for growth of 3 per cent or more in 1986 and 1987; outturn looks like being  $2\frac{1}{2}$  per cent or so in each year.

3. It was weaker external demand than expected, rather than weaker domestic demand, that accounted for the shortfall in growth - but that is only limited consolation.

4. We need to look closely at the differences between the main industrial countries, but we also and just as importantly need to examine the performance of the main industrialised countries as a group. Because we are concerned to avoid an inflationary or deflationary bias.

5. For the main industrialised countries as a group [G7] the growth forecast of  $2\frac{1}{2}$  per cent or a little more for 1987 and 1988 is disappointing : in present circumstances our economies should be capable of sustaining growth above, rather than below, the potential growth rate, and medium-term strategies should provide for that.

*In this case?  
Domestically,  
we boast about  
achieving  
sustained growth  
at just over  
 $2\frac{1}{2}$  %*

6. The point has been made time and again that domestic demand growth in surplus countries needs to be substantially faster than productive potential. Yet on OECD forecasts, domestic demand in Japan and Germany is expected to expand no more than  $2\frac{1}{2}$  per cent this year and next. Not only is this inadequate, it is comparable to that forecast for the United States. Indeed if the OECD forecast is right, then 1988 will be the sixth year in a row in which domestic demand in the United States grows as fast as, or



faster than, that in Japan and Germany. Such a development is simply not sustainable. It is the task of macro policies in each country to ensure a better balance, as has been agreed in successive meetings at the Louvre and Washington.

*Keynesian?* | 7. Ensuring appropriate growth in nominal demand over the medium-term is the task of macro economic policy. This will be made easier in a period of exchange rate stability. But a major reorientation of an economy towards domestic demand - in the case of Germany and especially of Japan - and some shift in the other direction in the United States requires more than just moving macro economic levers.

8. In the surplus countries, and especially in Japan because the size of the balance of payments surplus there in relation to exports is so large, a sustained programme of structural measures is needed. Higher levels of consumption and imports can be sustained more readily in a climate of freer trade, and more open and competitive markets. Greater liberalisation and deregulation are also needed so that the necessary investment, especially in housing, can occur without sparking off inflationary rises in asset prices.

### The UK

9. I can illustrate the importance of structural issues by reference to the UK. Growth in 1986 and 1987 taken together looks like exceeding the forecasts made by the OECD staff this time last year. The growth in the UK is not [as has been suggested by the Secretariat] a shortlived cyclical boom, but the continuation of steady growth, always close to 3 per cent, which began some six years ago. This sustained growth reflects major improvements in supply side performance, including three major features :-

- i) a much improved performance in export markets, with the UK's share of world trade in manufactures, in volume terms, stabilising in recent years.



ii) productivity growth in UK manufacturing in recent years has climbed back to almost the pre-1973 rate.

iii) the rate of profitability in the United Kingdom economy has been rising strongly year after year.

10. We are now seeing the rewards in the shape of growth at over 3 per cent and a falling level of unemployment [and an external position over the last year close to balance/low inflation].

### Structural Adjustment

11. Given the enormous importance of structural issues, it is entirely right that OECD should have devoted a great deal of its time and effort to these issues and I congratulate the Secretary-General on the excellent report on structural adjustment and economic performance.

12. I wholeheartedly endorse the main message of the report that market orientated policies are the way to promote structural adjustment and growth. When governments ignore the long-run consequences of their intervention in markets - however laudable the motives - and of higher public expenditure, taxation and borrowing, economic performance will suffer. UK has introduced numerous domestic measures to deregulate and reduce intervention in order to promote greater efficiency in government and greater competition in factor and product markets.

13. The OECD has a key role to play in those areas where international action is most needed: agriculture; trade and related industrial policies; financial markets.

### Agriculture

14. Nowhere are the damaging consequences of massive interference more apparent than in agriculture. Direct budgetary costs are huge, quite apart from costs to the consumer and to other sectors of the economy. Extent of problem has been well documented by the OECD, Fund, the World Bank and the FAO.



15. Fundamental reform to move to a market oriented outcome is essential. Requires a gradual and balanced reduction in all forms of intervention, including direct and indirect subsidies that encourage output.

16. OECD has done invaluable work in presenting aggregate measures of the many diverse forms of intervention used by the industrial countries. I propose annual updating of the OECD's technical analysis, together with an annual report on progress on agricultural reform, through the Economic Policy Committee, to the Ministerial Council.

17. It is of course in GATT that the major negotiations will take place. We must ensure that principles agreed at Punta del Este are respected, and that we concentrate not just on tariffs and quotas, but deal with all forms of support.

### Trade

18. Whilst agriculture is a most pressing problem, the Structural Adjustment Report rightly emphasises the need to strengthen and extend the open multilateral trading system as a whole. Any extension of discriminatory bilateral trade arrangements can only weaken a system already damaged by existing prolonged exemptions for textiles, steel and automobiles.

19. I attach very great importance to the work proceeding in GATT on new subjects of trade in services and intellectual property. Welcome progress made in OECD on the Conceptual Framework, and on specific work on financial services, maritime transport, tourism and insurance. Hope the Trade Committee will devote significant part of its resources to extending analysis of specific sectors, and that it will report on practical achievements on liberalisation to Ministers in 1988. Greater public awareness of the Codes of Liberalisation, and increased support for work on updating and applying the Codes will be an essential step towards increasing their effectiveness.



## Conclusion (including SSA)

20. Finally, if we can make further progress on both our macro policies and on our structural policies, we should be doing all we can to foster economic growth in our own countries, with all the benefits that can bring. At the same time, we should be contributing to a better outlook for the rest of the world.

21. Even so, some of the poorest countries face immense problems in securing any sort of worthwhile growth. Last month in Washington I proposed special treatment for the official debts of the poorest and most heavily indebted countries in sub-Saharan Africa. Let us all try and make real progress. Elsewhere, among the larger middle income debtors, we know that they have the capacity, if they choose to use it to their best advantage, to grow out of their problems. They and we will be greatly helped if we can succeed in developing the open and growing world economy that we all want.



CONFIDENTIAL

ORGANISATION FOR ECONOMIC  
CO-OPERATION AND DEVELOPMENT

CONFIDENTIAL

Paris, drafted: 30th April 1987

dist: 4th May 1987

C/MIN(87)2(Final)

Or. Fr./Engl.

COUNCIL  
AT MINISTERIAL LEVEL

TOWARDS BETTER ECONOMIC GROWTH IN THE CONTEXT  
OF GLOBAL INTERDEPENDENCE: PROSPECTS AND POLICIES

(Note by the Secretary-General)

INTRODUCTION

1. The OECD area is now in its fifth year of continued but moderate growth. Current forecasts point to rates substantially below those that were anticipated a year ago, not only for the OECD area but also for the rest of the world. It is therefore necessary to examine what can be done to reinforce the prospects for growth.

2. Part I of this paper deals mainly with the areas where problems are still occurring. It leaves aside the many aspects which are deemed to be satisfactory. Part II sets out the rationale for the many measures which can contribute to a more dynamic process of growth.

CONFIDENTIAL

W1127h  
Ta. 4685  
30th April - 1st May



## I. THE PRESENT INADEQUACIES

3. Progress has been made in Member countries, though unevenly, towards more flexible and adaptive economic systems. Despite this, however, economic performance is no more than modest in most Member countries. The economic and financial situation of many developing countries has deteriorated.

### A. Economic Performance in OECD Countries

#### Growth

4. Although there are differences between countries, the prevailing situation is one of disappointing growth, especially when set against the expectations formulated by Ministers in April 1986. At that time a number of favourable conditions prevailed -- a reduction of raw material and energy prices, a reduction of nominal interest rates, increased profits and better aligned exchange rates. Yet performance has failed to strengthen, despite lower inflation, with rates declining in most countries.

5. With few exceptions, investment remains slack. While household consumption has been maintained, government expenditure has slowed. External demand has been weak as a result of retrenchment of imports by the developing world. Forecasts now point to flat and unsatisfactory growth of around 2.5% to 3% over the next eighteen months, but even weaker in the very short term.

#### Employment

6. The employment picture remains gloomy almost everywhere. Job creation has, as foreseen, improved slightly but as the numbers of those seeking work has continued to increase, employment gains, in most countries, have been insufficient to make any inroads into the high levels of unemployment. It is the young and the long-term unemployed who find themselves at a continuing disadvantage. The appalling waste of human resources has not abated.



Current Account Balances

7. The United States' current account deficit and the surpluses of Japan and Germany reached exceptional levels in 1986, in dollar terms and as percentages of GNP. This provides in itself an indication of the scale of correction required to redress these imbalances. The rapid and substantial depreciation of the US dollar vis-à-vis the Deutsche Mark and the Yen is now having an effect in terms of volume. However, in dollars, the imbalances of the three major countries seem set to continue for several years. They will inevitably continue to be a source of uncertainty, therefore, especially in exchange markets. This uncertainty, made greater by the extreme volatility and the enormous volume of financial transactions, poses serious problems for economic policy in general and trade relations in particular, by increasing the threat of protectionism.

B. Structural Adjustment

8. Much effort and political capital has already been invested in a whole series of efforts to improve the structure of OECD economies. The flexibility of labour markets has been enhanced. Financial markets have undergone a profound transformation. The service sector, too, has seen extensive change. Some difficult adjustment has been made in the manufacturing sector, with progress in the reduction of unused capacity and some decline in subsidies. Agriculture is beginning, at last, to face up to adjustment. Nevertheless, much remains to be done in all of these areas to strengthen the underlying conditions for sustainable growth. There is a risk -- and one which should not be underestimated -- that if stronger growth appears elusive, all that has been done might well be jeopardised and the sacrifices and efforts needed might be considered of no avail. This risk will be all the more real if the public perception were to be, for instance, that:

-- wage moderation and labour flexibility do not translate into increasing real wages and growing employment;



- liberalisation of financial markets does not boost productive investment;
- withdrawal from industrial and agricultural activity for the benefit of countries which appear better placed is not associated with a fundamental and long-term strengthening of the adjusting economy.

If such a perception were to develop because of continuing poor economic performance, it would become inevitable that within countries and between countries frictions, misunderstandings and tensions would multiply. Unless the necessary patience is shown, the results of the structural adjustment efforts undertaken could be jeopardized.

#### C. Developing Countries

9. Differences exist among the OECD countries but even more so among the developing countries. A small number of developing countries are faring reasonably well. But, in general, the situation has deteriorated. Developing country exports have stagnated through weak growth in the OECD area and persistent market barriers. In addition commodity prices are severely depressed. External financing is also on the decline. The modest growth in official assistance is far outweighed by the reduction in commercial bank lending. Similarly, foreign direct investment has stagnated and there appears to be some evidence of repatriation of activities to the industrialised countries.

10. For many developing countries heavy debt burdens remain a major impediment to growth and adjustment, with serious social and political repercussions.



Facing up to a Period of Fundamental Change

11. The OECD economies are in the midst of fundamental change -- change impelled by new technology overlaid by international competition, by new financial activities, or by changes in society. These changes individually provide opportunities for progress but also pose challenges. The potential rewards in terms of social and economic progress are considerable. But to reap these benefits, it is indispensable to keep high the morale of the economic agents. If it were perceived that no improvement of the economic situation was in sight, more and more would refrain from taking far-reaching decisions. Instead of bracing for the future, they would try to perpetuate the past, condemning themselves to inevitable failure.

12. The role of governments is thus to promote the conditions permitting a greater confidence among the economic actors and the public at large. This governments can achieve through the quality of their management, international co-operation, and the fairness of the rules of the game they set, individually and collectively.

II. IMPROVING GROWTH PROSPECTS

13. Policies should focus on:-

- increasing the rate of sustainable, job-creating growth, based on the appropriate medium-term policy directions, without igniting inflation; this requires in particular stronger productive investment;
- reducing the massive balance-of-payments imbalances in the OECD area, particularly between the United States, Japan and Germany;
- improving the possibilities for growth in the developing countries.



When governments act within the frame of strengthened international co-operation both on general economic policies and on the multiple policies for structural adjustment, these objectives will be all the more readily attained.

A. General Economic Policies

14. It is essential that general economic policies support and sustain the process of current account adjustment between the three largest economies of the OECD area which has been initiated by exchange rate changes over the course of the past two years. The policy requirements are all the more critical because of the need to enhance growth prospects in the area as a whole. The following paragraphs review successively the requirements of fiscal and monetary policies in the United States, Japan and Germany, then in the other Member countries and in developing non-Member countries. The emphasis placed on the three principal economies reflects the special responsibility they carry at the present time in view of the scale of their external account imbalances.

Fiscal Policies in the United States, Japan and Germany

15. For the United States, the overriding priority is to continue the process of reducing Federal budget and current account deficits that has begun. This course is called for, not only to contribute to a more sustainable international balance and to greater stability of exchange rates, but also to avert an upward spiralling of debt service and deficits, to increase domestic savings and ensure that they are allocated to productive investment, to keep inflation at bay and to relieve upward pressures on interest rates. Delay could seriously affect confidence both in the United States and elsewhere. It is important therefore that an early agreement be reached between the Administration and Congress on specific modalities of implementing the multi-year programme to reduce the budget deficit. The simplistic idea held by some that the twin deficits in the budget and in the current account could be reduced



painlessly by a tax on imports must be discarded. It would undermine the foundations of the international trading system and the access to foreign markets for US products on which the adjustment of the US current account deficit ultimately depends.

16. Reduction of the US budget deficit will, of itself, entail some weakening of spending and growth. Given the boost to confidence that it could provide for investment in the United States and the prospect that, at present exchange rates, spending will shift in favour of US goods and services, this weakness is likely to be felt most strongly outside the US, where growth is already unsatisfactory. It is, in any case, essential that domestic demand, especially in Japan but also in Germany and in other countries in a similar situation, should grow more strongly than at present seems likely. This would support domestic growth and contribute to the reduction of external imbalances.

17. In Japan, not only must growth strengthen but domestic demand must increase more rapidly than output. The transition to more dynamic domestic markets should be accompanied by rapid growth in imports. As recognised and announced by the Japanese authorities, the government sector must make a contribution to achieve the stronger growth of domestic demand that is required. The diminishing deficits of recent years provide scope for marking time on further reductions without prejudicing medium-term budget consolidation objectives. Measures should also be taken to channel Japanese savings more towards domestic investment and imports. In particular, action should be taken to promote housing construction together with the deregulation of the use of land in urban areas. Easier consumer credit will also encourage consumption by households.

18. In Germany too, domestic demand, which has been relatively lively for over a year, must be actively maintained and exceed output growth. The slow growth of exports and recent uncertainty concerning exchange rates, which triggered a sharp scaling back of investment plans over the last two quarters, underscore the need



to ensure the vigour of domestic demand if growth is to continue and the already visible external adjustment to proceed. Fiscal prudence over recent years in Germany has created scope for a larger budgetary contribution to domestic demand, consistent with sound management of government finances. The Government has already begun to exploit these possibilities.

Monetary Policy in the United States, Japan and Germany

19. Monetary policies need to maintain a difficult balance in the period ahead. The fundamental requirement is to accommodate a non-inflationary growth within each country. Monetary stance seems broadly consistent with this objective and should remain so. In view of the outlook for inflation, policies seem to be consistent with a further market-led decline in interest rates, especially long-term rates in Germany and Japan.

20. The danger of exchange rate instability, and the consequent threat to confidence and growth, is likely to persist. Hence, the second requirement for monetary policy is to contribute to the orderly evolution of exchange rates. This will entail close co-operation among central banks. Such co-operation should aim to ensure that the balance between domestic easing of monetary policies in countries with strengthening exchange rates and adjustment in those with weakening exchange rates is appropriate in the light of overall demand conditions.

21. The co-operation envisaged in these fiscal and monetary policies is no easy task. The reward for success, however, would be better economic performance in these countries and an improved international environment for other countries, both inside and outside the OECD area. But other countries cannot be passive. They too must contribute to a more stable global environment in which economic performance can be improved.



Other OECD Countries

22. Policy requirements described above for the three largest economies apply generally to other Member countries, although both the size of the required actions and the specific mix of policies differ according to particular circumstances. Advantage should be taken of even limited scope for monetary policy actions. On the fiscal side, a number of countries have pursued budgetary consolidation, and this opens up for them possibilities for action. For those countries which adopted an expansionary fiscal policy during the first half of the 1980s, however, a priority is to restore sound fiscal positions in order to establish a more solid foundation for sustained growth. The fact remains that the onus is upon those countries which have a surplus on current account, to contribute to the strengthening of general economic activity, to the fullest extent compatible with the other features of their economic situation.

Developing Countries

23. A strategy for growth must have a global dimension. Economic performance and policies of OECD countries are major determinants of economic conditions in developing countries. Increasingly the economic performance and policies of developing countries also have an impact on OECD countries. It is clear, for instance, that the depreciation of the currencies of several Asian countries, in line with that of the dollar, has slowed down the correction of the US trade balance.

24. Greater consistency in policy directions and objectives in both developed and developing countries, especially those which will play an increasing role in world trade and investment, is needed so that interdependence functions in a way that reinforces the global growth process. This dimension of policy requires greater attention in the OECD countries; due consideration must also be given to the increasing diversity of situations within the developing world.



25. Debt problems are a major impediment to growth, with repercussions for the OECD economies. The three key elements of a medium-term approach for resolving the debt problems remain:

- the implementation of realistic growth-oriented structural adjustment policies in the debtor countries; 'adjustment fatigue' should not be allowed to endanger the continuation of these efforts;
- flexible new forms of financial co-operation by the international financial institutions and commercial banks to secure adequate support of structural adjustment programmes.
- macro-economic policies, trade policies and structural adjustment policies by OECD countries which are consistent with the implementation of growth-oriented adjustment strategies by the developing countries.

26. The international financial institutions, especially the World Bank and the IMF, have a key role in helping developing countries to put together effective policies and in ensuring adequate financing. They must have the resources for this. Renewed action is also required to improve the conditions for more active use of market capital, especially direct investment.

27. For poorer developing countries official development assistance remains essential. Donors should support policy reform efforts by reorienting their aid programmes to make well designed structural adjustment programmes work. Volume and forms of aid should be commensurate with the requirements of individual countries' policy reform programmes and broader development efforts. DAC members have recently adopted guiding principles putting new emphasis on aid for improved development policies and programmes and on strengthened aid co-ordination.



28. International action is needed to improve the prospects for developing countries relying heavily on commodity exports. In addition to the better functioning of markets and more rational trade and subsidy policies, international co-operation should emphasise structural and development problems of countries dependent on commodity exports.

B. Structural Adjustment

29. The report on Structural Adjustment and Economic Performance [C/MIN(87)3(Final)], submitted to this year's meeting in response to the request made by Ministers in 1985, surveys the experience of Member countries in the area of structural policies. It concludes that despite the progress towards freer economic systems which has been made in individual countries and areas, the OECD economies are still characterised by major distortions and rigidities. In the interests of stronger growth and a more stable world economy, vigorous action is called for. The benefits of interaction between bold structural policies and consistent macro-economic policies must be exploited to the full.

30. Well conceived structural policies can play an essential role in improving economic performance. They create an environment in which macro-economic policies and adjustment mechanisms are more effective. Economies that are more subject to the disciplines of private-sector competition are less inflation-prone, easing the task of fiscal and monetary policies. The resolution of current account imbalances is speeded up when economies respond more swiftly to major changes in relative prices. Micro-economic fitness means more action-prone enterprises and individuals.

31. Macro-economic policies must provide a medium-term orientation which contributes to the stability of expectations and the maintenance of confidence, the basic ingredients for initiative and risk taking. Without a healthy economic situation adjustment is difficult, albeit all the more essential.



32. It is also important not to lose sight of the contribution 'solidaristic' policies can make to better macro- and micro-economic performance. Adjustment demands painful efforts from individuals and enterprises alike. The various means -- ranging from social protection to the many different forms of redistribution via public expenditure -- which embody the notion of solidarity must be geared towards facilitating and accelerating the process of adjustment.

33. Action on a wide front is necessary to ensure that structural adjustment proceeds at the necessary pace. Priorities depend to some extent on the circumstances of individual countries, but a number of areas merit attention by all Member countries and offer scope for enhanced co-operation: trade, technological development and diffusion, socio-economic reform, financial markets, tax reform and agriculture.

#### Trade Policy

34. Trade and trade-related policies must have a central place in this approach. More liberal trade policies are the key to improved structural adjustment. It is in this area that the gap between announced official intentions and actual outcomes is perhaps greatest, while the effects of trade distortions are felt throughout each Member economy.

35. Though international trade has continued to grow, it has been fraught with increasing uncertainty as the threat and reality of protection came to the fore, aggravated by unsustainable configurations of balance of payments and exchange rates. This complex of uncertainties has eroded the incentives to invest and made macro-economic disequilibria yet more difficult to correct.

36. The launching of the new round of trade negotiations, encompassing major new areas such as services and agriculture, and the commitments made at Punta del Este, are of key significance in this respect. Determined pursuit of the Uruguay Round negotiations will contribute to creating a climate of confidence. It has to be



recognised that the generally poor implementation of earlier commitments to roll-back and standstill, the spread of discriminatory trade restrictions and the deteriorating situation in world agricultural markets render more difficult, but even more necessary, the new round of negotiations. Major continuing steps need therefore to be taken to reverse recent trends and to bring the trade policies of Member countries into line with the basic principles of the GATT system.

### Agriculture

37. Agricultural problems are the subject of a joint report [C/MIN(87)4(Final)] by the Agriculture and Trade Committees in response to the Ministerial mandate of 1982, as well as of a note by the Secretary-General [C/MIN(87)5(Final)]. There is therefore no need, in this note, for a lengthy analysis of the problem or for detailed proposals for action.

38. It is worth simply recalling here that public attention is now aroused. The OECD Ministerial Council meeting will be expected to make progress towards the solution of problems which, because of their financial cost and the international friction they generate, become more and more intractable.

### Financial markets

39. The profound transformations which have affected financial markets and the financial institutions in recent years show no signs of losing momentum. Alongside the clear benefits deriving from this process, significant concerns have emerged which call for the attention of governments to ensure the continued correct functioning of the new global financial system.

40. One feature of present developments, whose possible consequences could be far-reaching, is the replacement of traditional forms of bank lending by forms of negotiable instruments. This process of "securitisation" has advantages in



permitting better adaptation of financial operations to the needs of individual market participants, with an accompanying reduction in costs. However, the allocation of ultimate risks is not always clearly perceived, and some traditional distinctions, such as between short-term and long-term instruments and between the respective roles of banks, investment houses, insurance companies and security dealers, have become blurred.

41. A further consequence of the vastly increased volume of financial transactions and the global nature of markets is the reduced scope for autonomous policy for exchange rates or interest rates. Other consequences concern the growing need for adaptation of traditional forms of regulation and supervision to ensure the viability and stability of markets. Protection of investors and of non-financial enterprises and confidence in the integrity of the financial system are among the responsibilities of governments in all countries. Adaptation of regulation and supervision should ensure that the benefits resulting from a more competitive and dynamic functioning of markets are not impaired.

42. Important policy concerns have emerged in the area of security markets. New forms of international exchanges of information and co-operation in regulatory matters with respect to these markets are still in their infancy. Nearly all Member countries are in the process of reviewing national supervisory arrangements. It is important, therefore, to take advantage of this reformulation of national policies to seek to achieve increased compatibility and convergence of policies and develop a framework for international co-operation.

43. The combination of high real interest rates and an innovative financial system with its many instruments has attracted investors. Financial speculation is increasing. This may weaken the process of productive investment and job creation. It is therefore all the more necessary for governments to create the conditions that will restore the attraction of productive investment.



Tax Reform

44. Taxation now accounts on average for more than a third of GDP and in almost all Member countries this ratio has increased in the last decade. Some governments are examining ways to reduce the level of taxation, though most have focused on reforming their tax structures in a revenue-neutral way. During the last year the impetus for tax reform has quickened and at least half of the OECD countries have undertaken or are considering major tax reforms to deal with three main concerns: tax systems are too complex; the distribution of the tax burden is unfair; tax structures are adversely influencing decisions to work, save and invest.

45. Reforms need to identify those provisions which may encourage companies to undertake investment. Whilst there may be a case for well targeted investment incentives in certain specific areas (eg R&D), other such incentives generally yield questionable results, particularly when devised for short-term stimulation. Eliminating them would broaden the tax base and enable rates of tax to be cut. Some countries may also need to look at the relative tax treatment of distributed and undistributed profits and to eliminate as far as possible the influence of taxation on the choice of methods used to finance new investment. Personal income tax systems which combine very high marginal rates of tax and widespread tax privileges achieve little in terms of a redistribution of income but the high rates provide a strong incentive to reduce work effort, distort labour markets, and encourage non-compliance with tax rules. Governments should therefore be examining these aspects. In some countries there may also be a case for transferring part of the tax burden from income taxes into consumption taxes, which are generally seen as being more neutral towards decisions to save.

Technological Development and Diffusion

46. The open multilateral trading system is central to the rapid international diffusion of innovation because it provides incentives for technical advance, ensures that new goods and services are



speedily made available worldwide and that the high costs of Research and Development can be spread over a global market. Concerted action is required to extend the trading system, notably to services, to maintain a liberal approach to international investment, to sustain the free international flow of data and information, and to promote co-operative research efforts.

47. Technological change and increased productivity have long been a central element in the growth of output, employment and living standards. Recent progress in development and diffusion of new technologies points up many issues. These bear on the role of new technologies in the process of structural adjustment, on the macro-economic consequences of technical change, on the necessary adaptations of public policy and on the implications of new technologies for interdependence and international co-operation.

48. Technological change is a dynamic and complex process involving two-way interactions within the socio-economic system. It is already evident that in order to increase the economic benefits from innovation, public policies should be directed at expanding the scope for experimentation and entrepreneurship, (eg. by reviewing outdated regulatory restrictions); strengthening scientific and technological capabilities, notably at the level of basic research; improving industry's capacity to respond to emerging patterns of supply and demand; adapting education and training policies, as well as labour market policies more generally, to assist in the adjustment of skills to new requirements. Much work has already been done in the OECD and more is in prospect. This has, however, been tackled so far on a fairly fragmented basis. The task now is to put in place an overall programme to expand the scope of the work in the OECD and deepen the analysis in order to interpret better and make better use of technological advances. Such a programme should embrace the following:

- scientific progress and, in particular, the human resources on which it relies; and the means of improving its linkage and relevance to industrial and social needs;



- the process of creation and diffusion of technological innovation; obstacles to progress; means of promoting the process:
- the relationship between technological innovation and the organisation of production, including, in particular, repercussions for job destruction and job creation.
- the relationship between innovation and micro- and macro-economic performance;
- international implications.

#### Socio-Economic Reform

49. Structural changes in national economies both influence and are influenced by social attitudes and conditions. Three areas of socio-economic reform, all of which to varying degrees involve the private sector and the social partners as well as governments, are particularly pertinent: education and training, labour flexibility and social protection.

50. Education and training: There is a pressing need in most countries to improve the quality of education and training systems and to adapt them more to the needs of societies and economies undergoing rapid structural change. Without adequate investment in human resources the potential benefits of new technologies will not be realised, nor will the work force be able to move into new economic activities. Reforms are needed to improve basic education, to create new education and training structures between education and work, and to provide training opportunities for adults who need new or upgraded skills. For this, new partnerships are needed between education authorities and industry.

51. Labour flexibility: If workers have the means and the capacity to move readily not only between activities within the firm but also between firms and between regions, their longer term



security, motivation and career prospects will be enhanced. Ensuring this will mean dealing with non-portable pensions, housing problems and reduction of other relocation costs, and in some cases redirecting public expenditure from income support towards positive action to help the unemployed to get back to work, in particular for the long-term unemployed, whose chances of finding a job decrease significantly the longer they are out of work. The evidence is that an effort to reduce long-term unemployment would not add significantly to wage pressure. Active measures to promote training and working opportunities, such as local employment initiatives, are well warranted for this group.

52. When shocks and the requisite structural adjustments are large, some greater flexibility of wage differentials may be needed to serve as signals and inducements to workers and managers alike to acquire new skills, to change methods of production and to move to the new types of jobs that are emerging. There may also be both a need and scope to remove distortions which reduce employers' willingness to take on labour; taxes on employment may need to be reduced, possibly selectively, in some countries; and those rules which seek to promote job security but which in practice discourage the hiring of additional workers may need to be reviewed.

53. Social protection: In response to the apparently inexorable rise in public social expenditure, budgetary prudence has heightened the need to increase the efficiency of these expenditures and to promote necessary reforms. Much work is being done, including at OECD, in measuring health care output and in assessing numerous attempts to induce greater efficiency in prevention and treatment. For pensions, the major current problem is the budget implication of existing commitments as the pension structure matures; and around the turn of the century the budget burden will be increased yet further by the ageing of populations.

54. Despite the complex array of schemes, inadequate income support often results for some needy groups, for instance the long-term unemployed. Second, inadequate co-ordination has resulted



in irrational patterns of support to some groups. Third, income support schemes generally are often poorly integrated with labour market measures. Last, unemployment compensation and other assistance should be geared to encouraging entry or re-entry into training or employment.

55. Growth, job creation and social equity and cohesion are closely interlinked and are now dependent on resources and co-operation at many levels -- within enterprises; between employers, trade unions and governments; and between all three and local communities. Public policies need to evolve to deal with this reality, and in particular to provide a framework within which other groups and institutions can play their role.

#### CONCLUSION

56. Change and its implications are a recurrent theme in this paper. The fundamental transformation of economic and social structures touches each and every one. It is not unnatural that adjustment, and especially the pace of change, raises, in the minds of some, anxiety and concern about the future. It is for governments, in the main, to provide through the whole range of their social and economic policies the conditions that reinforce confidence and permit and encourage adjustment.

57. The OECD countries have, for several years, pursued a medium-term economic strategy aimed at achieving non-inflationary job-creating growth. Inflation is low and adjustment is taking place. However, satisfactory growth has not yet been obtained and unemployment seems stuck at appallingly high levels in many countries. Within the framework, therefore, of the medium term strategy, policies must provide greater support for growth, through the positive interaction between a concerted programme of structural measures and macro-economic management which exploits to the full the increasing scope for non-inflationary growth.



COUNCIL  
AT MINISTERIAL LEVEL

Meeting to be held at the Château de la Muette, Paris  
on Tuesday 12th and Wednesday 13th May 1987, beginning at 9.30 a.m.

DRAFT AGENDA

1. ADOPTION OF THE AGENDA
2. TOWARDS BETTER ECONOMIC GROWTH IN  
THE CONTEXT OF GLOBAL INTERDEPENDENCE:  
PROSPECTS AND POLICIES C/MIN(87)2(Final)\*
3. AGRICULTURE: THE NECESSARY ADJUSTMENT  
  
Ministerial Mandate on Agricultural Trade C/MIN(87)4(Final) \*to follow  
  
The problem of Agriculture C/MIN(87)5(Final)
4. A COMPREHENSIVE APPROACH TO  
STRUCTURAL ADJUSTMENT: THE ROLE  
OF TRADE AND OTHER POLICIES  
  
Structural Adjustment and  
Economic Performance: Synthesis Report C/MIN(87)3(Final)  
  
Conclusions of the Economic Policy  
Committee on Reform of Microeconomic Policies C/MIN(87)11(Final)
5. DRAFT COMMUNIQUE C/MIN(87)6
6. OTHER BUSINESS

\* This Note by the Secretary-General applies to Items 2 to 4 of the Agenda.



C/MIN(87)1

The following documents will also be made available to Ministers:

- Ministerial Mandate on Agricultural Trade  
Annexes I to VIII to C/MIN(87)4(Final) *Not attached.*
- Trade in Services  
C/MIN(87)7(Final)
- Main developments in the field of Trade Policy  
C/MIN(87)8(Final) *Not yet available.*
- Strengthened transparency and discipline in the field of tied aid credits and associated financing of exports  
C/MIN(87)9(Final) *BT*
- Development Assistance Committee guiding principles for associated financing and tied and partially untied official development assistance  
C/MIN(87)10(Final)
- Structural Adjustment: Technical Report  
SG/ADJ(87)1 Chapters 1 to 10 *not yet available.*