Parliamentary **Assembly**
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The OECD and the world economy

Report
Committee on Economic Affairs and Development
Rapporteur: Mr Ignacio Cosidó, Spain, Group of the European People's Party

A. Draft Resolution

1. The Parliamentary Assembly of the Council of Europe, enlarged to include delegations from the Parliaments of non-European member States of the Organisation for Economic Co-operation and Development (OECD), has debated the recent activities of the OECD on the basis of the 2006 report on *The OECD and the world economy* presented by the Assembly's Committee on Economic Affairs and Development and contributions from other Assembly Committees.

2. The Enlarged Assembly welcomes the continued resilience of the world economy in the face of such challenges as higher energy prices, incipient inflation and trade and fiscal imbalances in certain countries. These challenges require vigilant economic oversight with a view to taking timely and balanced corrective action where necessary.

3. The Enlarged Assembly considers that the liberalisation of international trade is one of the most effective measures for stimulating world growth. For this it is necessary to revive the Doha Round and continue working towards the elimination of the customs barriers and government subsidies to producers that undermine the free market, whilst recognising the special situation of the least developed countries in promoting fair trade.

4. To stimulate growth and prosperity, it is also necessary to ensure the stability and transparency of an increasingly efficient global capital market. To promote foreign investment, which is vital to guaranteeing more stable and balanced worldwide economic development, countries must guarantee a minimum of legal certainty so that political risks are not added to those which are specifically business-related.

5. Controlled migration flows may have a positive effect on world growth because of labour mobility towards the dynamic economies where labour is in greatest demand and because of the foreign currency remittances which these immigrants send back to their countries of origin. To keep control of this process of labour market globalisation, the sending and receiving countries must jointly pursue more appropriate immigration policies, including those for the integration of immigrants to society, and adopting measures to combat illegal immigration.

6. World economic growth is threatened by certain imbalances which may prove detrimental in the long term. Those countries which have an excessive and increasing public debt must accordingly be called upon to control their public expenditure. The excessive balance of trade disequilibrium in some countries may also prove in the long term to be a risk factor for the whole of the world economy.

7. The strong increase in the price of energy products is an obstacle to the growth of the world economy and a risk for the future if the trend persists. The Enlarged Parliamentary Assembly underlines that predictions of a steady increase in energy demand make it necessary to call for the development of renewable energy sources (solar, wind and bio-energy) and new generations of nuclear power, improved energy efficiency and increased investment in research and development on new, safer and cleaner energy sources. An increase in oil extraction and refinement capacity would also be necessary in the short and medium term.

8. The widening gap between rich and poor countries, which is especially dramatic in the case of Africa, calls for both an increase in the funds earmarked by the developed countries for co-operation and development aid and a far-reaching reorientation of that aid in line with the 2005 Paris Declaration on Aid Effectiveness. The priorities should be to improve environmental protection, conditions for women, education, healthcare, good governance and trade related infrastructure, as well as promoting pro-poor growth, in the countries concerned. The fight against corruption, a real cancer eating away at economic development in the poor countries, must be another priority on the international agenda. When providing development aid, it is important to be in line with national development strategies and priorities identified by recipient countries, and to adapt to differing country situations. Greater involvement of civil society is also needed, through such initiatives as the fair trade movement.

9. Agriculture and rural development are keys to development in the less advanced countries. The OECD countries must mobilise to enable agriculture to develop and these countries to prosper. Access for their agricultural products to the world market would also make it easier to curb the move away from the countryside and emigration, while ensuring a more balanced distribution of population.

10. Generally, but more specifically in the case of the European Union, whose growth, year after year, *has fallen short of their own expectations,* greater efforts must be made to implement the Lisbon 2000 Agenda. The pace of reform should be stepped up with a view to promoting sustainable economic growth together with a quantitative and qualitative improvement in employment and greater social cohesion. Such reforms should aim, among other things, at a better adjustment of the labour market to the needs of the business and other sectors, more flexible regulation of the economy so as to increase competitiveness, greater support for research and development, raising the standard of education and vocational training, and modernisation of the social welfare system in order better to combat social exclusion.

11. The reform processes across Europe that have been caused by European integration and the process of globalisation encompass the whole sphere of economic activity today. Working relations, social security systems, distribution of income – all have been put to the test and confronted pressure for massive change over the course of the last fifteen years. The European response must not be a race for the lowering of social standards. Peace, prosperity and social cohesion are based on the protection of those high standards. Instead, intelligent solutions must be developed which provide the ground for realising gains in efficiency and are generally acceptable to the people at the same time. It is therefore a matter of urgency to devise a common approach to meeting the three major challenges of globalisation, technological change and demographic change. The crux of the matter is clear: the European social model (which is distinguished by a specific balance between economic growth and social justice) must demonstrate its ability to respond creatively to these challenges.

12. Quality of life is more than financial prosperity and the price of humanity more than a pay cheque. In an increasingly interdependent world it is important to maintain a cultural focus and ensure that educational processes are adjusted to living as well as earning a living. For this reason the Enlarged Assembly continues to insist on the complementarity of the work of OECD with other more culturally

oriented organisations such as the Council of Europe. It looks forward with interest therefore to the contribution of OECD to the overview of European cooperation that will be made by the Standing Conference of European Ministers of Education when it meets next in Istanbul in May 2007.

13. Sustainable development requires that economic growth and social rights be reconciled with protection of the environment. To this end, the Assembly calls for full implementation of the Kyoto Protocol commitments with regard to climate change. Those countries that have not signed up to them should do so and new instruments of international co-operation should be conceived where necessary to meet other major challenges of environmental protection.

14. Democracy, political liberty and human rights are realities inseparable from economic and social development. Political instability and such human rights violations as child labour, human trafficking and discrimination against women all have an economic as well as a political impact. All Council of Europe and OECD member states should therefore reaffirm their commitment to democratic and human rights principles and values and step up their efforts to raise awareness of them across the globe.

15. The Enlarged Assembly believes that the OECD is uniquely positioned to serve as the hub for global economic policy coordination, bringing together its expertise and experience across the spectrum of economic policy. The Enlarged Assembly therefore calls on the OECD to facilitate discussion among key member countries, the European Union, leading non-OECD economies, and developing countries with the goal of reaching agreement on the core elements of a new global economic agenda. This agenda would be based on the OECD's mandate, namely the promotion of sustainable economic growth, trade liberalisation and development.

B. Explanatory Memorandum by Mr Cosidó, Rapporteur

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I. Background

1. In October 2006, the Enlarged Parliamentary Assembly of the Council of Europe will hold its annual debate on 'the OECD and the World Economy'. This report provides initial input for that session, and is particularly based upon the Rapporteur's recent meetings with officials at the OECD.

2. The Rapporteur wishes to express his gratitude to all those at the OECD who have helped to make this report possible. During his informative and wide-ranging meetings, he was offered a clear and fascinating view of current economic conditions, and of the circumstances that are shaping future prospects. While this report cannot hope to provide detail on all the topics raised, it does aim to set out an overview of key trends and questions for the global economy, and to discuss a series of challenges that seem, to the Rapporteur, of particular relevance. These include long-term increases in energy prices, the need to preserve global financial stability and make progress with trade liberalisation, and the development of more effective frameworks for delivering international aid.

3. In addition, the report takes a look at the OECD's new multinational benchmarking project, designed to build the competitiveness of member countries, and entitled 'Going for Growth'.

II. Introduction: prospects for the world economy

i. Overall performance remains strong

4. Like his recent predecessors, the Rapporteur can deliver a cautiously positive assessment of global economic performance. In late 2005, there was a noticeable slowdown in global economic growth, but the signs are that it is now rebounding. Overall, world trade is projected to expand at a fast clip, with last year's relatively subdued growth of 7.3% expected to increase to around 9% this year and next. Accordingly, OECD real GDP growth having fallen back from 3.3% in 2004 to 2.8% in 2005, it is expected to reach around 3.0% during this year and next.

5. In fact, the world economy has proved surprisingly resilient; for the weaknesses and uncertainties reported last year, and described by the OECD as 'headwinds', remain significant and continue to pose downside risks. Most importantly, the price of oil has remained high, and price volatility has been compounded by distribution bottlenecks and supply disruptions, with transport and refinery capacity being poorly matched against geographic demand. Alongside this, and at least partly associated with it, are factors such as high commodity prices, a tightening of conditions in the Chinese economy, and the peaking of housing markets in a few countries.

6. A key feature of this resilience is that, in contrast to previous periods of high energy prices, overall price stability has been maintained. Although headline inflation figures have inevitably risen, this has not as yet translated into higher prices for most non-food or energy products, nor into higher wage demands, which could cause an inflationary spiral. This is seen, at least in part, as a testament to the increased competition in international markets – in addition to a more energy-efficient industry in developed countries, and lower labour costs in developing countries – as well as to the enhanced credibility of central banks. Assuming that there is no further rapid rise in oil prices, the OECD believes that inflationary pressures may now tend to recede, without the need for rises in interest rates beyond what would normally be required as economies move back towards their potential levels of activity.

7. Another important factor is the strong performance of companies and financial markets. Stock exchanges have recovered a lot of the ground lost in 2001, while corporate balance sheets and profits remain strong, with business leaders adapting their activities to meet the new patterns of globalisation. And indeed, with abundant global liquidity, there is a great deal of investment money available in the world today, looking for opportunities with good returns. Resurgent and emerging economies have found no shortage of investors - and so developed countries are increasingly challenged to raise their productivity and maintain competitiveness.

8. It is also worth noting that higher oil prices are improving the export potential for many countries, as oil producers spend the additional revenues being earned. For economies with weak domestic consumption, such as several of the largest in the Eurozone, export growth has become a crucial factor in maintaining growth, and the OECD expects that demand will rise strongly during 2006.

ii. A *broader base of growth*

9. Compared with previous reports, it is encouraging that the OECD sees the world's economic expansion broadening, and incorporating regions that have previously been weak. As was pointed out last year, the recovery of the world economy since 2001 has been not only sporadic, but geographically uneven. Now though, the United States has remained buoyant, and has withstood the aftermath of last year's hurricanes, while other English-speaking countries have done well, despite the cooling of housing markets. Meanwhile, growth in Japan has taken a stronger hold in the domestic economy, and there are real hopes of a sustained upturn in the Eurozone. Key developing countries in the Americas and Asia have done well, and in particular, the Chinese economy has resumed its extraordinary growth, with substantial benefits for its trading neighbours. Asia's growth is also being boosted by rising demand in the electronics sector.

iii. But there is a need for caution – and reform

10. While the present outlook for the world economy seems relatively benign, the OECD points out that it also is beset with short-term vulnerabilities - and long-term structural challenges, which need to be addressed if the current performance is to be sustained.

11. The most immediate threat is the cost of energy. Should there be further significant price increases, or should today's rising prices push up underlying inflation, a tightening of monetary policy would be needed. This could mean a dramatic increase in interest rates, which would have an even stronger effect than it has in the past, given the reliance of many of the developed world's fastest growing economies on buoyant housing markets and consumer credit.

12. Allied to this, there is a considerable risk attached to the large, and still growing, current account deficits, most notably in the United States. In recent years, these deficits have been relatively easy to finance. But any reduced willingness by foreigners to finance US debt, which would manifest itself in a back up of longer-term interest rates, could have a serious impact in a short space of time – which would, in turn, have a disastrous effect upon the developing economies that are increasingly important players in the world economy, both as producers and export markets. Moreover, the euro area as well as Japan, where the authorities have limited room to respond with monetary or fiscal policy, would also be hard hit.

13. These risks underscore the point that current favourable circumstances cannot be taken for granted, and make it all the more important for economies to continue their efforts toward structural reform. However, the fiscal deficits of many OECD countries remain large, and the OECD-wide deficit is expected to show only modest improvement (as per cent of GDP) over the next three years. The OECD is repeating its call upon governments to 'make serious headway towards achieving sustainable public finances', pointing out that an aging demographic profile will dramatically increase spending pressures on most developed countries in the generation to come.

14. In this context, the OECD highlights the importance of continuing efforts to achieve deregulation, both for domestic economies and in terms of international trade – and in particular, the importance of resuming negotiations and reaching an agreement during the current WTO DDA round is underlined. Meaningful progress in this area will, as it has in the past, improve the long-term growth prospects of the entire world economy.

III. A survey of key economies

i. The United States

15. At 3.2%, GDP growth in the United States during 2005 was slightly lower than had been forecast, in large part because of a dramatic slowdown triggered by the severity of the hurricane season in the final quarter of the year. The effects of this on overall economic performance are expected to be temporary - and the most recent data points to a sharp recovery in early 2006, with GDP growth for the year now being expected to slightly exceed last year's level.

16. Despite the oil-intensive nature of the US economy, its underlying strength and momentum has enabled it to withstand the rapid rise in oil prices. During most of 2005, private demand remained healthy, with strong productivity growth, and the housing market continuing to boom; meanwhile export levels recovered, although still outstripped by import growth, and employment figures grew rapidly. The unemployment rate fell to around 5%, and the OECD expects this trend to continue, with the rate falling to 4.7% in 2006, and in 2007.

17. While the steep rise in oil-related fuel costs has pushed US headline inflation higher, underlying inflation has so far risen only moderately, with manufactured product increases remaining very subdued and no marked upward movement of wages.

18. Accordingly, the rise in policy controlled interest rate has been both gradual and steady – although their pace will have to be quickened should the persistent strength of the economy begin to exert upward pressures on underlying inflation. There has, as well, been a welcome improvement in the federal budget deficit, due to higher than expected tax receipts, reflecting the dynamism of corporate earnings and unearned personal incomes.

19. Despite the continuing recovery in export volumes, the US external current account deficit has not narrowed, and is expected to be close to 7% of GDP in 2007. The US continues to show an insatiable demand for imports, and is finding it difficult to curb government spending. Alongside this, American consumers save very little, and there is a rising gap between domestic saving and investment, which is covered by foreign saving. Thus, the main engine of world growth will remain indebted to an extent never before seen in history.

20. In summary, while the outlook for the US appears healthy, there are several factors that create uncertainty. While the economy has dealt with higher oil prices better than many had expected, further dramatic increases (or even a prolonged period of prices at current levels) can be expected to challenge current projections for growth. And much depends on the continued willingness of global financial markets to sustain the country's ever-increasing current account imbalance. And as has been pointed out in previous reports, America's role in fuelling world growth means that these risks are shared by everyone.

ii. Asian economies

21. The economy of Japan performed strongly in 2005, with GDP growth attaining 2.75%, and though activity is likely to slow somewhat in the next two years, key indicators suggest that Japan has completed a good part of its post-bubble adjustment, allowing for stable and consistent future growth.

22. Japan's progress has been underpinned by private domestic demand, as well as strong corporate profits. While growth was at its strongest in the first half of 2005, industrial order books and consumer confidence have remained relatively buoyant. Indeed, business confidence is at its highest level in more than a decade, as the benefits of commercial restructuring come through, and there is evidence that the recovery is extending to the non-manufacturing sector, as well as to small and medium-sized enterprises. This broadening improvement has been spurred on by an increase in bank lending, as the major banks have succeeded in reducing their bad debt levels and restoring their own balance sheets.

23. As a result, wages and household incomes have recovered, and unemployment has continued its steady decline, from 5.3% in 2003 to 4.4% in 2005, with the 2007 figure projected at around 3.5% Importantly too, for the first time in a decade, there has been a shift from part-time to full-time employment.

24. Despite a mild fiscal contraction in 2005/6, designed to restrain the government deficit, the Japanese economy is still expected to grow at around 2% to 2.5% during this year and next (in 2006 growth may on average attain 3% due to a strong carry-over from 2005), with export growth – which slowed slightly during 2005 – expected to pick up through renewed overseas demand. These prospects could, of course, be jeopardized by the impact of oil prices on world markets, although Japan's own economy is perhaps the most energy-efficient in the developed world. In the OECD's view, the most serious domestic risk lies in any sudden tightening of financial policy, in a bid to restrain incipient inflation, and which might instead encourage the return of deflation. Under current world conditions, therefore, the OECD urges that any monetary policy changes should be pursued cautiously.

25. In Korea, too, domestic demand has picked up strongly; having fallen for several years, in the wake of the 2002 credit bubble, private consumption rose by 3.2% in 2005, and is expected to grow by just over 4% this year. And despite relatively low business investment levels and labour market difficulties, export volumes have also recovered, led by demand from China and other Asian economies, so that GDP growth is likely to rise from around 4% in 2005 to a range of 5% in 2006/7.

26. If export markets remain healthy, the prospects for Korea's economy should be bright – and will only be enhanced by any growth in business investment. This should, in turn, be stimulated by a recent increase in worldwide demand for information and communications technology products (the ICT sector), which accounts for around a third of Korea's current exports. The lingering effects of Korea's credit bubble pose a risk, however, with around 10% of the working-age population still in payment default; in addition, the government's efforts to stabilise real estate prices have brought higher interest rates, despite a slowing of core inflation, which could especially threaten the recovery of smaller businesses.

27. The impact of emerging powers such as India and China on the global economy is receiving ever-greater attention. India has experienced annual growth averaging 8% over the last three years, a performance underpinned by high levels of savings and investment. This has enabled the government to reduce public deficits, while embarking on much-needed subsidy reforms and public investment in infrastructure, as well as welfare and education services, which should enable a step-change in its long-term growth potential.

28. Meanwhile, the economic rise of China is beginning to reshape the patterns of world trade - and its effects within Asia are especially strong. In fact, China is now both Korea and Japan's largest trading partner, and has recently accounted for more than a third of their export growth. Overall, China is now the world's second-largest trading country and exporter, and by some measures it is already the world's second-largest economy.

29. In 2005, China's economic growth remained above 9%, and it is likely to continue to do so during this year and the next. Recent growth has been assisted by a surge in exports, but private consumption has also remained strong. Investment patterns have shifted towards the private sector, as the government has sought to restrain the economy by slowing construction projects and state-controlled industries. This has tended to reduce the growth of imports into China; but as affluence grows, and restrictions are eased, imports are likely to pick up again. Indeed, although the OECD expects China's headline trade surplus to grow from around $150 billion in 2005 to $202 billion in 2007, this will represent only a small increase when seen as a proportion of the country's GDP.

30. Of course, China continues to face an array of social, political and environmental challenges, that demand continued rapid growth, while simultaneously putting it at risk. And in the medium term, China's success will depend on the extent to which it continues to reform. There is a particular need to restructure state-owned banks and enterprises (especially in the energy and power sector) - and to develop better social protection, especially in terms of land rights, health care and pensions, to ease the burden of transition on the majority of the population who have not yet shared in the country's increasing prosperity.

31. But according to the OECD, perhaps the most immediate risk to China's growth lies in the interaction between exchange rate policy, which is managed and cautious, and monetary policy, which is also managed but is being driven in an expansionary direction, as large foreign currency holdings are built up. Given China's high growth demand, the danger is that lending and credit will surge, risking inflation and an overheated economy. The OECD suggests that China should allow further appreciation of its currency, rather than relying on the official management of credit.

iii. The Eurozone

32. During last year, the OECD described the Eurozone economies as 'plodding along', but also made what was called 'a reasoned, but positive, bet' on their prospects for recovery. In part, this was due to Europe's relatively oil-efficient economy, and the US dollar pricing of oil. But it was also because of the Eurozone's inherent lack of resilience. And with currency considerations having prompted manufacturers to become more efficient and competitive, the renewed pick-up in world demand should present a major opportunity.

33. Overall, export performance has cushioned the eurozone in recent years, and now offers an important means to growth – though, as in many factors, the benefits currently differ widely between individual countries. Germany's export performance has been particularly strong – indeed, it is currently

the world's largest exporter - but France has seen some erosion of its position, and Italy, which has been losing competitiveness in recent years, has suffered a decline in its share of world markets.

34. Last year was broadly disappointing for the Eurozone, with a predicted recovery failing to take hold and growth of just 1.4%. However, activity has strengthened in the first half of 2006, and on this basis the OECD predicts an acceleration to around or possibly above 2% in 2006, before falling back slightly to between 2 and 2.5% in 2007.

35. The Eurozone should be well-placed for an upturn in business investment, with strong corporate cash-flows and balance sheets, and still low borrowing costs. However, investment plans have tended to be postponed due to a series of economic and political shocks and by the uncertain tempo of economic and labour reforms, especially following the failure of the EU constitution and political uncertainties in the three largest member states.

36. Persistently high levels of unemployment underline this difficulty. In 2006, unemployment fell below 8% for the first time since 2001 and is projected to be between 7 and 7.5% in 2007. Here again, though, progress varies widely between different countries. In Italy, labour market reforms have encouraged the hiring of new workers, and unemployment has been reduced from 8.6% in 2003 to a projected rate somewhat below 7.5% during 2006. In Spain, meanwhile, high domestic demand and an economy growing at more than 3% a year have helped to bring down unemployment from 11.5% in 2002, to 8.5% by mid-2006.

37. In France, recent reforms have made some improvement to labour market conditions, but the challenge is formidable. Youth unemployment levels are among the highest in Europe, at 23%, and total employment in France was actually lower in mid-2005 than it had been in mid-2002. Currently, the OECD describes private sector employment growth in France as 'almost imperceptible'. Employment growth in Germany is still largely accounted for by small-scale part-time employment and subsidised work schemes, although unsubsidized job creation has picked up recently..

38. In Germany, as in other countries such as Belgium and the Netherlands, lack of domestic demand is still making it hard to achieve growth with strong job creation; France has a similar, though less acute, difficulty here, and has been assisted by a recent boom in property prices. In fact several Eurozone economies have benefited from this, although in Germany prices have actually been in long-term decline relative to the prices of consumption goods. In the OECD's view, sustained increases in housing wealth can have long-term benefits for consumption, and liberalisation of property financing and taxation would contribute toward this. Moreover, this effect is significantly boosted if households can borrow against their equity.

39. But as it is, subdued demand within the Eurozone's major economies is having a 'drag' effect on the whole area. Italy, traditionally a major exporter to Germany, has suffered from this, and the expansion of smaller, fast-growing economies such as Ireland and Spain is inevitably constrained. Given the Eurozone's fiscal rules, and the fact that government deficits are already running at levels that threaten to be unsustainable in the future, there is no room for fiscal stimulus.

40. This suggests that Eurozone countries must push ahead with policies of economic deregulation and reform, however difficult that may be in the short term – and there are encouraging signs that this is taking place, with individual countries throughout the area engaged in intense public debate on tackling the very different challenges that affect them. The question has also been raised in some quarters as to whether excessive and bureaucratic regulation emanating from the European Union itself has in fact slowed Eurozone growth. Equally, there is an increasing recognition of the common challenge presented by an aging population profile, the options for dealing with it, and the additional costs that workers will have to bear in the next generation.

41. In addition, the OECD reiterates that a phased reduction of producer-support in the agriculture sector, and an opening of markets in line with current trade liberalisation talks, will be in the long-term

interest of Europeans – as well as being an inescapable element of doing business internationally, in an era of globalization.

42. In this context, the Rapporteur draws attention to the need to counter, in the interests of the growth of the Single European Market and through robust intervention by the European Commission, the recent protectionist trend in Europe whereby some governments are seeking to prevent foreign acquisitions of domestic enterprises.

iv. The United Kingdom

43. With the end of its house price boom, and a weakening in retail sales, UK growth slowed from 3.1% in 2004 to around 1.8% in 2005. In the OECD's view, this is not entirely unwelcome, since that economy has been operating at, or above, capacity for some time. And with continued strength in the service sector, business investment and house-building showing strong growth, and a pick-up in export markets expected, GDP is likely to grow by 2.5% in 2006 and just below 3% in 2007.

44. Unemployment has remained subdued, at around 4.8%, and below the OECD's estimate of its structural rate; and a rapid increase in immigration has both relieved labour market pressures and boosted the economy's potential growth rate. While rising energy prices have pushed inflation above 2%, wage increases have remained moderate.

45. Given these circumstances, the OECD feels that the Bank of England 'can afford to wait and see' whether to stimulate growth by cutting rates. It does, however, point out that the government deficit is likely to remain at or around 3% on current terms, and that if revenue projections are not fulfilled, action will be needed to reduce it. Additionally, to improve long-term growth prospects, the OECD calls for steps to improve workplace skills and training, and to extend current reforms of the disability benefit system.

v. Other key economies

46. In Canada, the economy has withstood a strong appreciation of its currency; in fact, export volumes have increased, and GDP is expected to continue to grow at around its potential rate of 3% over the next two years. Although domestic demand growth has slowed slightly, it still represents the major growth driver, and most of the domestic fundamentals are strong, with healthy income levels, housing prices, and unemployment at its lowest rate in 30 years.

47. Canada is a net oil exporter, and therefore benefits directly from higher prices, although it would also be heavily exposed to any slowdown in the US economy. Further, it may find that high oil prices drive its currency still higher, which would adversely affect other exports. With some inflationary pressures now emerging, Canada has begun to increase interest rates; given the country's favourable circumstances, the OECD believes that this can safely continue. Additionally, it suggests that measures will soon be needed to prepare the economy for the effects of a rapidly aging population.

48. As a major oil exporter, Mexico has also benefited from higher revenues, which have underpinned increased levels of public investment. Following a slowdown in early 2005, mostly brought about by weakness in its export markets, growth has picked up, reaching around 3% in 2005, and with 3.9% expected during 2006.

49. With a recovery in export growth, and the sustained expansion of investment and household consumption, the near-term outlook for Mexico is promising. Inflation has been falling, while the current account deficit has narrowed and Foreign Direct Investment has remained buoyant. Employment, too, has grown pretty strongly.

50. The key risks for Mexico are thought to be the dependency of the budget upon oil revenues, and the challenge to competitiveness posed by newly-emerging economies. The OECD recommends that measures be considered to raise productivity and to step up the potential for GDP growth, including reforms of the tax and education systems, and to increase local investment and business efficiency.

51. The economy of Brazil slowed significantly in the early part of 2005, so that full year growth fell from 4.9% to 3.2%. The latter part of the year, though, saw improving circumstances, and growth of 3.7% is expected in 2006.

52. Private consumption has increased, with consumer credit booming, and real earnings have boomed, as unemployment has declined from 7.6% in 2004 to an expected 4.7% in 2006. Moreover, inflation has remained under control, and the government is advised to maintain its policy of fiscal consolidation, reducing debt and capping expenditure in relation to GDP.

53. The outlook is fairly positive in eastern Europe, too. In the Czech Republic, surging exports have brought growth rates to 6% in 2005, and further strong growth is expected as domestic demand strengthens, heralding a continued fall in unemployment. In the Slovak republic, GDP growth is likely to remain strong, hitting close to 6% in 2007, and foreign direct Investment remains healthy – although in the absence of further structural reform, the OECD expects unemployment to remain high.

54. While growth has slowed in Poland, it is expected to pick up again, with GDP increasing by over 4% in 2006, as consumption and investment recover. Unemployment, which was nearly 20% in 2003, is projected to be around 16% in 2007 – but again, the OECD warns that a lack of structural reform could slow this process. Meanwhile, the economy of Hungary has rebounded from its 2004 slowdown, with growth expected to be around 4.5% over the next two years, and tax cuts, export growth and public investment fuelling demand. In the OECD's view, however, Hungary's fiscal policy is 'off track', and further slippage on the government's budget targets could force a tightening of monetary policy, threatening growth prospects.

55. In Russia, there have been solid achievements in recent years, but the OECD is concerned about near-term prospects. GDP growth has moderated , from 7.2% in 2004 to an expected 6.2% in 2006, and is likely to be lower still thereafter. This comes despite booming world energy markets and is mainly due, in the OECD's opinion, to growing capacity constraints. . Despite an upsurge in international investment inflows in the first half of 2006, further opening and better policy transparency would, according to the OECD, attract much-needed investment to support the country's modernization and economic diversification.

56. During 2005, oil-sector output has virtually ceased to grow, and the volume of exports actually fell slightly. The economy has remained vibrant, however, due to high levels of domestic demand, encouraged by a credit boom that accounts for around a third of increasing current consumption. In these circumstances, inflation has proved difficult to reduce and, the OECD says, is exacerbated by industrial wage increases that exceed productivity gains, and by rapid growth in public sector wages and pensions.

57. Despite these issues, the extent of the government's fiscal stimulus has so far been limited, with much of Russia's recent extra oil revenues used to repay debt and build a stabilisation fund. But the OECD points to clear risks for the economy if authorities do not keep to their medium-term strategy, which foresees a slowdown in spending growth during 2007. This is all the more important when oil revenues are exerting upward pressure on the exchange rate, and when the progress of new structural reforms has tended to be slow. In that context, the OECD's latest Economic Outlook discusses the increasing role being taken by the state in industries that it sees as strategic which, it says, 'hardly bodes well for growth.'

IV. A look at key future challenges

i. Energy

58. Despite the resilience of the world economy to recent increases in oil (and natural gas) prices, there has inevitably been an impact on growth, and previous predictions of a gradual price decline have not materialized. Instead, some commentators are now warning that the market will remain volatile, while prices will continue to rise, over the medium term, towards $100 per barrel. Could this happen?

59. Everyone agrees that we will see increasing demand. Total oil demand has increased by 15% since 1995, with the US and China accounting for nearly half of that increase, and demand is expected to rise by another two-thirds over the next 30 years. Reserves are thought to be adequate to meet this level of demand over the next few decades, and economists would normally expect such increases to add no more than about $8 to the price of oil.

60. But there are a number of special factors. Firstly, as the OECD points out, Chinese demand has been underestimated in recent years, and this is one of the reasons for the price rises already experienced. With so many developing economies now growing strongly, there is a risk that this could happen again, and on an even bigger scale – and this, in itself, is enough to make energy markets nervous. For spare capacity in oil extraction and refining is currently very low, and investment in new capacity is not proceeding fast enough.

61. Political uncertainties have affected investment in exploiting new oil reserves, and this is a sector where investment is not necessarily allocated according to market forces. Meanwhile, the transport and refining system is inadequate to meet current demand patterns. Environmental pressures have brought a shortage of refining capacity in the developed world, for instance, as was graphically demonstrated after Hurricane Katrina. Low profit margins during times of low oil prices as well as NIMBY ("not in my backyard") have also been factors that have discouraged construction of new refineries. It should be noted that most existing refineries have been upgraded since built to increase their output capacities and for conversion (for new product specifications, etc). There is also a mismatch in the type of oil available. While there is high demand for light products (especially in the transport sector, which accounts for most oil demand), new production is increasingly heavy. This tends to be the case across geographic areas. There is however a growing geographical mismatch between where oil is produced and where it is consumed. There is also increasing competition amongst countries to obtain long-term energy supplies by building favoured relationships with major producers.

62. All in all, then, the price of oil seems likely to remain high – and could well go higher. On top of that, security of supply will become an ever-more pressing issue. And at the same time, we are beginning to see what appear to be the first effects of global warming. Scientists are increasingly agreed upon the dangers, and warn that Europe, for instance, is threatened not only by a gradual change in climate, but by freak effects such as persistent drought, by the flooding of low-lying areas, and a dramatic cooling of north-western Europe as the Atlantic gulf-stream is disrupted.

63. So it is not surprising that governments across Europe are reassessing their energy policies, particularly as North Sea oil and gas production declines and after the disruption in natural gas supplies from Russia in early 2006. In the Rapporteur's view, far more emphasis should be placed by governments on encouraging research and development spending on renewable energy sources and the nuclear option. Similarly much more effort should be placed on improving energy efficiency as this offers huge potential through existing technologies at low or even negative cost to reduce energy demand and lower CO2 emissions. Informed and realistic public debate will be vital if the continent is to face these challenges effectively – and new forms of international agreement will also become necessary. On the one hand, Europe will need to feel confident that its new supplies of traditional energy, particularly from Russia, are reliable; and on the other, we will need new mechanisms to tackle climate change. For while the Kyoto Protocol was a radical measure when first put forward, the growth of developing countries means that, even if its targets are achieved, the pace of global warming will not be arrested. Fortunately there appears to be a growing awareness that current trends in global energy demand are not sustainable. In July 2005, the G8 invited the International Energy Agency (IEA) to attend its summit in Gleneagles. Participants placed high priority on the development of strategies to mitigate climate change, secure clean energy and achieve sustainable development. Their goal was to ensure a "clean, clever and competitive energy future". The resulting Gleneagles Plan of Action mandates the IEA to identify pathways for G8 policy makers to realize this objective through energy-sector innovation, better practice and use of enhanced technology. In response to this request, the IEA has developed an initial set of concrete actions to improve energy efficiency which were endorsed by G8 leaders in St. Petersburg. The IEA is currently undertaking further work under the Gleneagles Plan of Action. This will become the subject of discussions at the German and Japanese G8 summits in 2007 an 2008 respectively.

ii. Financial stability

64. As we have seen, the growth of world trade isunderpinned by the free flow of unprecedented amounts of capital. Foreign investment flows are running at about $12 billion each week, and every day up to $1,300 billion is transferred around the world via foreign exchange transactions. This, perhaps, is the life-blood of modern globalisation, and there is no doubt that it has brought new prosperity to many countries in the world in an astonishingly short space of time. But it can also bring about almost instant disaster, as several countries have found to their cost. There has already been market pressure on some emerginc market economies and rising interest rates, the reversal of the carry trade and low risk premia have traditionally been associated with a potential threat to financial stability.

65. The phenomenal scale of modern capital flows strengthens the case for international co-operation, so as to ensure the transparency and stability of the global financial system. In 1999, following the Asian financial crisis, the G7 established the Financial Stability Forum, with a membership drawn from international governments and institutions, and on which the OECD is represented. Their task is to improve co-ordination, assess vulnerabilities in the system, and oversee solutions – particularly via international standards and codes that promote sound financial systems. They have warned that, in current conditions and given the potential for increased risk aversion, there is a need for enhanced vigilance and supervisory control. And a strong commitment to good corporate governance is needed, they say, to maintain market confidence and encourage more stable, long-term investment flows. In doing so, they have welcomed the OECD's recently-revised Principles of Corporate Governance, which are serving as a framework for a joint OECD/World Bank effort to improve corporate governance worldwide. The revised Principles emphasise the need to consider the costs and benefits of regulatory initiatives regarding corporate governance to ensure that they promote transparent and efficient markets, and enhance market integrity and overall economic performance. In addition, the OECD has now established Guidelines on Corporate Governance of State-owned Enterprises and these are serving as the basis for intensified efforts by both the OECD and the World Bank to improve standards, especially in non-member countries where it is a key element in improving governance more generally.

66. The world's increasing prosperity and complexity has, in addition, opened up new levels and types of risk. The insurance industry has been particularly challenged, for instance, by the rising cost-levels incurred by natural disasters. To take just one recent case: it is estimated that the losses resulting from the 1994 Northridge earthquake were equal to the entire total of premiums collected for earthquake insurance during the 20th century. And the industry has now to deal with a new threat – international terrorism. Prior to the September 11 attack, the largest insured loss in history, terrorism was generally not even referred to in insurance policies.

67. Moreover, climate change seems already to be having a major impact on the insurance industry. Swiss Re, the world's second largest insurer, has estimated that the economic costs of global warming could double to $150 billion each year in the next 10 years, hitting insurers with $30-40 billion in claims. But it may turn out to be even worse: 2005 was the costliest year ever, with the highest number of hurricanes and tropical storms since records began, triggering losses of more than $200 billion and insurance claims running at more than $70 billion. In 2004, the previous most costly year for weather-related incidents, losses totalled about $145 billion and claims reached $45 billion. Commenting on these figures, the chief executive of Munich Re Foundation, said that "there is a powerful indication that we are moving from predictions of the likely impacts of climate change to proof that it is already fully under way."

68. The insurance industry, it should be said, has proved remarkably resilient, and adept at shifting its business models to cope with changing circumstances, by devising new measurement principles and spreading risk through reinsurance. So the concerns that the industry expressed to last year's G8 summit should send a powerful warning to us all. Their continued viability is of great importance, since so many of the world's activities - and key business sectors, such as pharmaceutical research and air travel - could of course not continue without it. Even now, though, there are areas of activity that have become virtually uninsurable (asbestos exposure risk is a well-known example), and projects that have been cancelled due to the premiums required, such as the construction of new 'ultra-large' oil tankers. Meanwhile, 'frontier'

initiatives such as nanotechnology are difficult to insure, and this suggests that there is a need for public/private approaches in some areas, to ensure that potentially beneficial new technologies are not lost.

69. Already, some governments have adopted limit liability measures in areas such as nuclear power – and there are now many formal public/private partnerships that cover terrorism risk. All of this should serve as a reminder that the mechanisms on which the world economy is founded are surprisingly fragile, and will have to be continuously monitored and adapted.

iii. Trade liberalisation

70. Ever since the post-war foundation of the GATT, the liberalisation of trade has been a vital element in the world's economic growth. Today, the success of the WTO's Doha negotiating round seems very much in doubt – although, as one OECD official has put it back in early July, 'at least the train is still on the track'. Following last December's conference in Hong Kong, it is important that a broad agreement is reached amongst the negotiating partners by July (thus maintaining fast-track negotiating status for the US delegation), so that a deal can be concluded by the end of the year. If the July deadline is not met, it will be extremely difficult to conclude the Doha Development Agenda within the timeline imposed by the US Trade Promotion Authority. An inability to do this would probably main the failure of the Doha cycle, and that would be a major setback for the world economy, and would have a particularly severe impact on the progress of developing countries, who stand to gain two-thirds of the worldwide income increases from trade facilitation, for instance, and some $68 billion from tariff lowering.

71. The Rapporteur was told that there are still reasonable prospects for a positive outcome, but that most of the progress made in Hong Kong was heavily qualified, and the hard decisions are therefore still to come. In particular, an agreement on cotton is thought to be essential; the concerns of African producers have as yet only partially been addressed, and the agreed ending of cotton export subsidies represents only 10-20% of the support that the US gives its farmers.

72. Alongside this, a general commitment to the phasing out of agricultural export subsidies needs to be defined, and there are a host of subsidiary issues. For instance, an arrangement to replace the preferential access enjoyed by some developing countries in specific markets of the developed world is still under discussion. This 'preference' system, by which goods such as bananas from one country have a massive tariff advantage over any competitors, is an obvious market distortion; but in the OECD's view, if the adverse effects of ending this system are addressed by appropriate packages of assistance for the limited number of countries concerned, they should not prove to be an obstacle to completion of the Doha Round.

73. Clearly, agriculture and farm-related issues will remain contentious, and while the OECD certainly feels that producer-support should continue to be reduced, they point out that for a successful outcome to the talks, 'what really matters is the political will to correct the uneven trade landscape we find ourselves in'. An OECD study published just before the Hong Kong meeting reminds us that this is not only in the interests of the developing world: a successful conclusion, it says, would bring about a benefit equivalent to a 3% increase in GDP for developed countries, with a cumulative effect on average earnings equal to between 1 and 2 years additional income, across a working lifetime.

74. Of course, it is not only the developed world that is cautious about liberalisation. Some developing countries have, for instance, expressed concern about the effects of multilateral tariff reduction upon their own governmental revenues. While the OECD believes that the potential gains from such tariff reductions are sizeable and will, in GDP terms, be most significant for these very countries, it nevertheless accepts that potential revenue shortfalls could undermine their overall economic stability, affect the progress of development programmes, and even cause a reversal in the progress of trade reform. Through its Development Assistance Committee (DAC), the OECD is therefore encouraging and tracking trade-related assistance and capacity building programmes to support trade development strategies in developing countries, based on wide national consultation processes; in particular, the DAC recommends targeting donor assistance toward institution-building, an expansion of production and export facilities, the

development of infrastructure and the streamlining of trade regulations. Moreover, the Trade and Development Assistance Committees have jointly contributed to the deliberations of the WTO Task Force on Aid for Trade by examining the effectiveness of existing trade-related assistance programmes and how to make aid-for-trade an effective tool for helping developing countries, and in particular LDCs, to fully benefit from trade liberalization and WTO agreements. The OECD supports the Recommendations of the Task Force, and in particular its proposals to widen the scope of aid for trade, build on the Paris Effectiveness principles of local accountability and mandate the WTO to review annually the effectiveness of aid-for-trade programmes.

75. Perhaps the biggest threat to trade progress is what the OECD calls 'a potent mix of fear and complacency'. In the Rapporteur's view, all parties involved in the Doha Round of trade negotiations need to continue with an ambitious long-term strategy, while showing realism in the short term, so that this agreement can be reached, and the ongoing process of trade liberalisation maintained. At the same time, he underlines the OECD's opinion that rounds of implementation should be incorporated in any final agreement, so that progress is measurable, and transparent to all.

76. The WTO General Council supported at its July 27-28 meeting a recommendation by Mr. Lamy to suspend the Doha negotiations owing to lack of agreement on market access modalities. This marked a decisive moment in the young life of the multilateral trading system, and efforts are now focused on re-generating momentum behind the talks.

77. The present impasse is a lose-lose situation, in which all countries suffer but the poorest will suffer most. The OECD has estimated at nearly $100 billion the gains in terms of increased economic activity – and hence prosperity – that could be obtained from full tariff liberalisation for industrial and agricultural goods. The benefits from liberalising trade in services – the fastest growing sector of the world economy - could be five times higher, at around $500 billion. A Doha agreement on trade facilitation, by clearing away procedural barriers, could contribute at least $100 billion more. Developing countries are projected to reap as much as two-thirds of these gains.

78. Beyond the gains forgone, there would be serious systemic risks arising from stalled multilateral reform. The world economy would forgo an opportunity to address critical issues including global imbalances, population ageing and poverty. The backlash against globalisation would gather momentum, and protectionism will rise. Existing distortions to trade and economic activity could become entrenched, making it increasingly difficult for developing countries to compete fairly in world markets.

79. Moreover, other initiatives will fill the gap. Bilateral and regional trade deals will proliferate even more than in recent years. These can introduce systemic strains through the diversion of trade and investment, and through the increased costs imposed on business by the proliferation of rules of origin and product standards.

80. A successful outcome of the DDA is still possible. Indeed, the basic rationale for pursuing the Doha Development Agenda is as valid today as when the Round was launched back in 2001: to promote global economic growth and, in particular, improve economic development opportunities for developing countries, and to strengthen the multilateral trading system. Failure to successfully conclude the Round will bode ill for all countries, especially for developing countries.

iv. Improving the effectiveness of international aid

81. At a time when the world economy is expanding so rapidly, co-operation between developed and developing countries is crucial to ensuring sustainable, balanced growth. And with many countries still mired in poverty, it is increasingly being recognised that international aid and development programmes need to be both more substantial, and more effective.

82. In 2000, the UN's Millennium Summit produced a declaration of goals – affirmed by 189 countries - to be reached by the year 2015, and designed to tackle poverty and social inequality. Two years later, 180 developed and developing countries met at Monterrey, Mexico, and stressed their mutual

responsibility for the achievement of the Millennium Development Goals: developing countries would need to improve domestic policies and governance, while developed countries would have to step up their support, by offering better access to markets and by providing more and better aid. Commitments made by developed countries at and since Monterrey are projected to increase aid levels to 0.36% of national incomes by the year 2010 (there was also a reaffirmation of the UN's own long-term aid target of 0.7% , first agreed in 1970).

83. This was an important step, reinforced by decisions at the G8/Gleneagles and UN Summits in 2005. Progress is being made. Official Development Aid rose by 31% in 2005 to a record high of US$106.5 billion. But this includes substantial debt relief for Iraq and Nigeria which will continue to boost ODA in 2006. Excluding debt relief, the increase in 2005 was 8.7%. From 2007 to 2010, ODA will need to increase by 10% annually to match commitments made, and will be the fastest growing item in many developed country budgets, and this will require sustained political and public support. Organising this aid so that it is disbursed in a timely and effective way will be a major challenge (see further below). At the same time, as people in developing countries vote with their feet, migrant workers around the world now send home at least $167 billion each year. Remittances and ODA can be powerful complementary flows, since ODA is concentrated on the poorest countries, whereas remittances flow largely to middle-income countries

84. Welcome as the prospects for increased aid are, real development impact will depend on success in addressing the key obstacles to the effectiveness of aid. The involvement of numerous agencies, some local and some external, and often operating with different systems of management and measurement, can lead to duplication, inefficiency and confusion. It also makes it difficult to guard against the threat of corruption. Without good planning and more predictability, there will be a lack of good programmes and projects available on which additional funding can be spent, with the inherent danger that spending budgeted resources quickly will be seen as more important than achieving long-term results. Those results can be extremely hard to quantify, too, without better statistical systems in developing countries (being addressed by the Partnership for Statistics in the 21st Century - PARIS 21) and better allocation and conditions of aid (more rational distribution patterns and less tying of aid).

85. In March 2005, a high-level forum on aid-effectiveness resulted in the Paris Declaration, which went well beyond previous agreements in its ambition and scope, and in which donor and recipient countries agreed 'to reform the ways we deliver and manage aid'. A key theme of the meeting was 'capacity development', the need to boost the ability of recipient countries to absorb aid funds successfully, and use them efficiently. In the OECD's view, this is the key operational challenge to the delivery of the Millennium Goals, and the solution to this is 'country-owned change', driven by the recipients of aid, and supported by the donors.

86. Accordingly, the Paris Declaration involves detailed commitments, indicators of progress and time-bound targets to be reached by 2010. The objective is to align aid with developing countries" own priorities and to rely on their national management systems upgraded to meet common acceptable standards. It involves major efforts to harmonise aid delivery, by eliminating duplication of effort and simplifying donor policies and procedures.

87. The OECD is determined that the Paris Declaration makes a real difference in improving the effectiveness of aid, and through the Development Assistance Committee is hosting an international partnership of donors and recipient countries that works to foster implementation of the Declaration in developing countries and to monitor progress internationally. Results from the first survey on monitoring the Paris Declaration will be available in 2006. The Declaration involves adapting to the varying situations of different countries, and paying particular attention to the needs and circumstances of the world's most fragile states, which have tended to be left behind while other countries have experienced rapid growth. In fact, some of the latter – for example China, India, Mexico and Thailand – are themselves becoming substantial aid donors. In the coming years, a larger focus on fragile states is particularly essential both to contribute to international stability as well as the achievement of the Millennium Development Goals given that one third of those living on less than $1/day live in fragile states. In an effort to address these challenges members of the OECD-DAC, in partnership with the UN and the World Bank, have recently

begun piloting the "Principles of Good International Engagement in Fragile States "which recognize that a lasting solution for these states will need to be driven by their own leadership and people, but that 'real improvements in donor behaviour' can help to promote better results.

88. The twelve Principles emphasise the need for international actors to move from reaction to prevention, to align with local systems and policies, and establish state-building as the primary objective. In addition, they seek to promote practical coordination between donor agencies, using shared planning mechanisms, and enshrining basic operating criteria. For instance, agencies are urged to be careful that they 'do no harm', unintentionally impeding their own long-term progress by such steps as bypassing national budget processes, or setting local salary levels that are unrealistic in that context. And while acknowledging that speed of response is always thought to be – and often is – crucial, the principles suggest that a long term, consistent commitment is certainly no less important.

89. Piloting of these Principles is taking place in collaboration with the member countries of the Development Assistance Committee, and is intended to provide the basis for consultation, and gathering information and experience in order to make revisions as appropriate. Pilots currently underway include the Democratic Republic of Congo (in collaboration with Belgium), Guinea Bissau (in collaboration with Portugal), the Sudan (in collaboration with Norway), Somalia (in collaboration with the UK and the World Bank), the Solomon Islands (in collaboration with Australia and New Zealand), Haiti (in collaboration with Canada), Nepal (in collaboration with the UK), Yemen (in collaboration with the UN) and Zimbabwe (in collaboration with the EC).

90. Projects such as this are much to be welcomed, and should be an important means of demonstrating to the governments (and voters) in developed countries that there are real and lasting benefits to be gained by committing themselves to international development.

91. As an important complement to efforts underway at the OECD to improve the effectiveness of official development assistance, a number of initiatives aim to enhance and promote the private sector's contributions to development. For example, the Policy Framework for Investment, developed jointly by a task force comprised of 60 developed and developing country governments between 2004 and 2006, is a non-prescriptive toolbox intended to help countries mobilise private investment that supports steady economic growth and sustainable development. The Policy Framework for Investment aims to advance implementation of the United Nations Monterrey Consensus, which emphasises the vital role of private investment in effective development strategies. Likewise, as a complement to the 'principles for good international engagement in fragile states' mentioned above, the OECD recently developed a 'risk management tool for investors in weak governance zones'. Recognising the important potential synergies between official development assistance and private investment, the OECD Investment Committee and the DAC have worked closely together to develop policy guidance for donors (*Promoting Private Investment for Development: The Role of ODA).*

v. Encouraging transparency, fighting corruption

92. Clearly, there is also an inescapable link between the defeat of poverty and good governance. Under the auspices of the OECD, the Development Assistance Committee's Network on Governance (GOVNET) aims at improving the effectiveness of donor support for good governance, and thereby supporting capacity development. As an international group that brings together experts from development organisations and aid agencies, as well as representatives from partner countries, GOVNET has a unique role in building the foundations of country-owned change, as outlined in the Paris declaration.

93. GOVNET aims to provide members with an opportunity to exchange experiences, as well as identifying and communicating best practices, and developing new and shared analytic tools. Its work focuses on how to improve the quality of donor involvement in a broad range of governance-related areas, including democracy and the rule of law, human rights, and public sector reform. It also covers the relationships between the state and citizens, civil society and the private sector – and crucially, it has a focus on the fight against corruption.

94. This forms part of a substantial collaborative effort against corruption, undertaken in recent years. The OECD has worked in partnership with the European Union, and with the Council of Europe, which has itself initiated anti-corruption principles, and a detailed code of conduct, as well as a series of specific conventions relating to corruption; these adopt a deliberately broad interpretation of corrupt practice - covering trafficking in influence, as well as passive and active forms of domestic and foreign bribery, in both the public and private sector.. The centerpiece of OECD anti-corruption efforts, the 1997 OECD Anti-Bribery Convention, captured worldwide attention as the first global instrument to fight corruption in cross-border business deals. Today bribing a foreign public official is a crime in the 36 countries that have ratified the Convention. The OECD Anti-Bribery Convention also ensures enforcement of the laws through systematic monitoring by the OECD Working Group on Bribery. Related OECD instruments put an end to the tax deductibility of bribes to foreign officials, deter bribery in officially supported export credits and require anti-corruption provisions in development aid. (See www.oecd.org/daf/nocorruption) And in 2003, the work of many international agencies was rewarded with the signing of the UN Convention against Corruption, which set out a global framework of binding rules and standards.

95. There is close on-going co-operation between the OECD and the Council of Europe in this area, particularly focusing on areas such as money-laundering and economic crime, and the OECD is represented in the Council of Europe's GRECO project. GRECO (Group of European states against corruption) is a monitoring mechanism, which aims to assist its member-countries to fight corruption by following up, through a process of mutual evaluation and peer pressure, and enforce compliance with the relevant Council of Europe standards. GRECO currently has 40 member countries (the most recent being Ukraine, which joined in January 2006), and issues regular public reports upon its members' performance.

96. Such collaborative, multi-lateral efforts are recognition of the fact that combating corruption is a long-term commitment, involving the international community as well as a country's government, its institutions, the private sector and civil society. In this spirit, GOVNET's draft anti-corruption principles were presented in September 2005, as an explicit attempt to place donor countries in a role that supports developing countries in their own anti-corruption efforts. Stated briefly, the principles are that donor countries should:

- Collectively foster, follow and fit into the local vision.
- Acknowledge and respond to the 'supply-side' of corruption (in other words, address the issue of corruption initiated from the donor country).
- Marshall knowledge and lessons systematically, and measure progress.

97. It is hoped that these principles (now being trialed and tested by GOVNET members) will help to gain international consensus for, and agreement on, the fight against corruption – and will therefore be a valuable element in the development of a global framework for effective donor action. In seeking to make international aid more effective, there is surely no struggle more important than the promotion of honest and transparent governance, which will both inspire greater confidence amongst donor countries, and offer enormous benefits to those living in the world's most challenged countries.

V. An OECD bench-marking initiative: 'Going for Growth'

98. One of the key objectives set out in the OECD's founding charter was that it should 'promote the highest sustainable growth' of member economies. And the organisation has long been renowned for its regular country and sector-specific studies. During 2005, the OECD built upon this expertise, with the launch of a new form of benchmarking, a multi-country report entitled 'Going for Growth'. The project's objective is to address the increasing divergence in living standards recently seen amongst OECD member countries, by testing individual performance against a range of structural and policy indicators. This allows an objective assessment of delivery and performance, rather than simply a comparison of cultural differences, and enables specific recommendations to be offered.

99. The 2005 report focussed primarily on labour and product markets, involving an examination of productivity and regulation, education, tax and public investment practices, and barriers to competition. The detailed analysis is well worth reading, for it contains a wealth of interesting comparative data – and results in five key recommendations for each member country (and for the EU as a whole), at least one of which applies directly to labour productivity. To take just a few examples:

- In the UK, the tightening of current disability benefit rules is seen to be a priority, while the government is also urged to improve access to training, and to increase investment in the transport infrastructure.

- For France, it was recommended that older-age working be made more attractive, that employment protection rules be eased across the board, and that minimum labour costs be reduced.

- Spain was advised to improve wage flexibility by limiting the extent of administrative extension of collective agreements, while Italy was urged to reduce public sector ownership levels, and Germany to reduce the cumulative tax burden upon labour.

100. For the EU as a whole, the suggested priorities were to ease business regulation, lower barriers to competition in network industries such as telecommunications, to reduce the levels of producer-support in agriculture, encourage labour mobility, and to achieve a broader integration of Europe's financial markets and the financial services industry.

101. The 2006 'Going for Growth' report summarises these findings and recommendations – and shows, point by point, what steps have been taken by individual countries to address these issues. As the OECD remarks, there has been useful progress toward increasing competition via the easing of barriers to entry and a reduction of regulation, while a number of initiatives have also been undertaken to improve competitiveness through training and work initiatives. But moves to improve labour flexibility, either by lowering employment taxation or revising legal restrictions have been rare, and relatively timid, especially as regards encouraging employment for older workers.

102. In addition, this year's report introduces a further strand of measurement, 'Encouraging Innovation'. Here, the OECD points out that much of the rise in living standards since the industrial revolution has been the result of innovation – and while accepting that the uncertain nature of Research and Development makes it difficult to measure true performance, the report establishes a series of indicators: R&D intensity at both national and industry-specific levels, patent registrations, education standards (particularly in maths and sciences), venture capital investment and the involvement of foreign affiliates. It also looks at a range of policy indicators, such as taxes, regulation, and special subsidies. Amongst its key recommendations:

- Both Germany and Japan are encouraged to stimulate private sector funding of innovation and the development of business investment - in the former case by removing barriers and distortions in the tax system that discourage venture capital, and in the latter by encouraging foreign investment, access to venture capital, and by paying special attention to smaller, technology-based enterprises. Meanwhile France, which has relatively restrictive product market regulation, is also advised to streamline procedures for small and medium-sized enterprises.

- Italy is urged to increase tertiary education graduation rates (less than 15% of Italians now aged between 25 and 34 have taken part in tertiary education, compared with nearly 40% in France and more than 50% in Japan). Education is also considered a priority area for the UK, where the objective should be to raise enrolment rates at upper-secondary school levels, and to increase research carried out by governmental and educational institutions.

- According to the report, Poland should reduce barriers to entrepreneurship, particularly by reducing the administrative burdens upon start-up business, and improving the country's

technology and knowledge-based infrastructure. A similar recommendation applies to Hungary, which is urged to raise incentives for commercially-based research. And in a further variation of that theme, it is suggested that Finland should reduce the 'manufacturing bias' in public support for R&D, so as to enhance the capacity of its service industries.

103. Overall, the EU is urged to give priority to R&D projects that have the greatest knock-on effects, to remove its own barriers to trade - especially in services - that inhibit innovation and growth, and to implement a community-wide patent system.

104. This year's study closes with a look at the relationship between GDP growth and a society's general sense of well-being. It suggests a range of additional measures that can be used to assess the overall well-being of a country, such as income distribution and inequality, leisure time, health, and environmental quality. The analysis concludes that, as an indicator of the economic aspects of well-being, there is no better comparative guide than per capita GDP – but that a more comprehensive assessment of well-being requires a variety of measures. In itself, this discussion is thought-provoking – and although the inter-country comparisons it undertakes are deliberately tentative, it is intriguing to wonder if this might one day become a formal element of OECD benchmarking!

105. While that particular change may still be some way off, the OECD is planning to steadily expand the scope of its benchmark indicators, so as to create an increasingly comprehensive account of the factors that influence economic performance. 'Going for Growth' is, in the Rapporteur's view, an extremely positive contribution to the debate now taking place in many OECD member countries about how to adapt and position their societies in the coming generation; and its development should help them to make the most of their potential - and to share best practices amongst each other - in an ever-more dynamic, and challenging, world economy.

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Reporting committee: Committee on Economic Affairs and Development

Reference to committee: Standing mandate

Draft resolution adopted by the Enlarged Committee on Economic Affairs and Development on 3 October 2006

Members of the Committee: Mr Evgeni **Kirilov** (Chairperson), Mrs Antigoni **Pericleous Papadopoulos** (Vice-Chairperson), Mr Márton **Braun** (Vice-Chairperson), Mr Konstantinos Vrettos (Vice-Chairperson), MM. Ruhi Açikgöz, Ulrich Adam, Hans Ager, Mrs Edita **Angyalová**, Mr Abdülkadir Ateş, Mrs Doris **Barnett**, Mrs Veronika Bellmann, MM. Radu-Mircea Berceanu (alternate: Cornelia **Cazacu**), Akhmed Bilalov (Alternate: Nikolay **Tulaev**), Vidar Bjørnstad, Jaime Blanco (alternate: Elvira **Cortajarena**), Luc Van den Brande, Patrick Breen, Erol Aslan **Cebeci**, Mrs Ingrīda Circene, MM. Valeriu **Cosarciuc**, Ignacio **Cosidó**, Ioannis **Dragassakis**, Joan Albert Farré Santuré, Relu Fenechiu, Mrs Urszula Gacek, MM. Carles Gasóliba, Francis **Grignon**, Kristinn H. Gunnarsson, Alfred Gusenbauer, Nick Harvey (alternate: James **Clappison**), Norbert **Haupert**, Anders G. **Högmark**, Željko Ivanji, Ivan Ivanov, Igor Ivanovski, Miloš Jeftić (alternate: Ivica **Dačić**), Karen Karapetyan, Serhiy Klyuyev, Anatoliy **Korobeynikov**, Oleksiy Kunchenko, Jean-Marie Le Guen, Harald Leibrecht, Rune Lund, Gadzhy Makhachev (alternate: Liudmila **Pirozhnikova**), Edward **Maniura**, David **Marshall**, Jean-Pierre Masseret, Miloš Melčák, José Mendes Bota, Attila Mesterházy, Mrs Ljiljana Milićević, MM. Neven **Mimica**, Gebhard **Negele**, Bujar Nishani, Conny **Öhman**, Mrs Ganira Pashayeva, MM. Claudio Podeschi, Jakob **Presečnik**, Jeffrey Pullicino Orlando, Maximilian Reimann, Mrs Maria **de Belém Roseira**, MM. Kimmo **Sasi**, Bernard **Schreiner**, Samad Seyidov, Leonid Slutsky, Ms Geraldine Smith (alternate: Bob **Laxton**), Mr Christophe **Spiliotis-Saquet**, Mrs Aldona **Staponkienė**, MM. Stanislav Stashevskyi, Frans Timmermans, Mrs Jelleke Veenendaal, MM. Oldřich Vojíř, Varujan Vosganian, Robert **Walter**, Paul **Wille**, Tadeusz **Wita**, Mrs Rosmarie Zapfl-Helbling (alternate: John **Dupraz**).

Also present: Baroness **Hooper**, Mrs Sinikka **Hurskainen**

Canada: Mrs Milne, Mr Harb, Mr Tilson
Japan: Mr Murata, Mr Tsutsui, Mrs Kano, Mrs Wada
Korea: Mr Eom, Mr Yang
Mexico : Mrs Green, Mr Castellón

N.B: The names of the members who took part in the meeting are printed in bold

Head of Secretariat: Mr Newman

Secretaries to the committee: Ms Ramanauskaite and Mr de Buyer