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No. 234 – October 2002

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FT Business
FINANCIAL TIMES

What global warming?

In his article, Global warming: What comes after Kyoto?, Professor Burton Richter's arguments are based on two incorrect premises – one explicit, the other implied (OECD Observer No. 233, August 2002). His very first sentence asserts "Every study of global climate change has concluded that world average temperatures are rising..." This is quite clearly contradicted by the best available data, which come from weather satellites: Global atmospheric temperatures show no perceptible warming trend since 1979. This surprising result is confirmed independently by radiosondes launched worldwide daily by weather balloons.

Not only do these observations contradict the results of theoretical climate models, but these same models also demand that the atmosphere warm faster than the surface. We must therefore conclude that the models have not been validated and cannot be relied on to predict future warming.

The implied premise in Professor Richter's article is that global warming is harmful or even catastrophic. Economists, many of them on his Stanford campus, disagree with this assessment. Their published studies indicate a rise in GDP, with the agricultural and forest sectors benefiting most from a warmer climate and higher levels of carbon dioxide.

The Kyoto Protocol, even if punctiliously observed, is virtually ineffective. There is general scientific agreement that by 2050 it would lower the calculated temperature by only 0.05C, one-twentieth of a degree. This value drops to 0.02C, if the US abstains from Kyoto, as seems likely after the unanimous vote against it by the US Senate in 1997 and after President George Bush termed the treaty "fatally flawed".

Finally, the replacement of fossil fuels by the large-scale use of nuclear energy will, in my view, be the inevitable outcome of the gradual depletion of low-cost sources of oil and gas. High values of atmospheric CO_2 will be a transient event in the history of industrial civilization.

S. Fred Singer
Professor Emeritus of Environmental Sciences,
University of Virginia,
United States

Eurasian reserve

You raise the question of whether the euro could one day become a more important international reserve currency (Observer 230 January 2002). Yet you omit to mention the Panglossian forecasts of some economic commentators a few years back who had predicted a massive shift of international reserves into the euro and out of the dollar – with a consequent surge of the euro. These predictions were not surprisingly way off the mark, as many of the component parts of the euro were "currency weaklings", which weighed down the euro like lead sinkers rather than help it swim up. And then, the lynchpin of the European economy, Germany, became the sickman of Europe.

The euro has gained in value recently of course, but is this strengthening durable? As you point out, there are structural reasons for doubting this. But one key point missing from your analysis is where are all those international reserves? According to statistics from the Bank of International Settlements, most of the world's official foreign exchange reserves are to be found in East Asia, especially Japan, China, Chinese Taipei, Hong Kong-China and Korea. These countries are just across the "Pacific lake" from the US, and mostly have very strong economic and political links with the US. Moreover, they all look up to the US as the global leader, and will take a long time to convince of any merit of swinging into euros.

The fledgling process of Asia/Europe international co-operation (ASEM), which recently held its summit in Copenhagen, left many observers still wondering whether this great idea will ever achieve anything. If Europe wants a strong currency, it may need reforms, but it will certainly have to strengthen its ties with those countries in East Asia that sit on the biggest piles of official foreign exchange reserves.

Cathie Cashmere
Cronulla, Australia

On the cover

Corporate governance: Who's responsible? The cover photo is a reworked version of a photo from the Hulton Getty creative collection (© Getty Images) at www.HultonGetty.com. Taken in 1964, it captures boardrooms as many people see them: somewhat remote, private, even rather murky, places. Shareholders and stakeholders demand more transparency and increasingly high corporate standards, but when it comes to leadership and governance, who's responsible?

Better values for better governance

Donald J. Johnston, Secretary-General, OECD

We are inundated these days with concerns about corporate governance. Corporate executives are under attack and major auditing firms are worried, as well they might be in the wake of the demise of one of their giants, Arthur Andersen. Enron, WorldCom, Tyco – what should our reaction be to these extraordinary and outrageous breaches of faith with shareholders and employees?

To begin, we must make a few distinctions which seem to be lost in this flood of revelation. There may indeed be some criminal behaviour in a number of these sad stories. The law will be brought to bear in such cases and justice will hopefully be served. But there are also indications that even in the absence of criminal behaviour, some corporate managers have ceased to see themselves as stewards of other people's money. Rather, they prefer to see themselves as partners entitled to huge "entrepreneurial" rewards for doing what they are already extremely well paid to do.

We read much about rewriting rules to contain corporate abuses. But is a thicker rule book really the answer?

In the case of public companies with widely held shares, the temptation of managers to "take advantage" is enormous. We have witnessed the consequences. Is it conscionable that top executives can earn as much as 400 times the salaries of the plant floor workers? William McDonough, president of the New York Federal Reserve Board, raised this point in a speech on the anniversary of 11 September. What corporate manager is really worth that? Frankly, none. Let us remember that the CEO of a large public company is fundamentally a *manager*, surfing on the assets of others, happy to catch the upside of the business cycle, but not happy with the downside, and thus often seeking to re-base their stock options or other perks.

Will regulations change these attitudes? No. It is corporate culture, and the incentives that shape that culture, which must change. Top managers of widely held companies are in effect accountable to no one. In reality, it is these managers who usually name the directors. These in turn are then only too happy to support those who appoint them, rather than the shareholders who in theory they represent, but only in theory. Senior managers have an obvious incentive to put other CEOs on their remuneration committees, not critical, independent directors. Hence "you scratch my back, I scratch yours" becomes the basis for ratcheting up executive remuneration to levels far beyond the dreams of avarice.

Meanwhile, the major shareholders – the pension funds, the insurance companies, and so forth – too often do not play the role they should. Why? Perhaps because they can always vote by selling their shares, which is a lot less messy than sitting on boards and overseeing management. These large institutional shareholders potentially have enormous clout, but they have not exercised it very effectively to discipline top management. Perhaps now this will change and the large institutional shareholders of public companies will finally start to act like "owners".

There is one important caveat to all this. It concerns the entrepreneurs of this world who, from scratch, and often risking everything they have, manage to create enormous wealth for others, and for themselves. Good for them; that is the risk and reward principle that has made *entrepreneurial* capitalism, as opposed to *bureaucratic* capitalism, such a potent force for creating mass prosperity. But those who seek to become billionaires through the management of other people's ideas and money are another matter.

Let us be clear about the real issue. Where corporate behaviour involves criminal activity, we have judicial systems to deal with that. But today, the vast majority of the excesses of the corporate executive class really have nothing to do with criminal activity. The more fundamental problem has to do with a breakdown of traditional capitalism which has seen the role of the owners of capital undermined through diffusion of interest, leaving no one to speak clearly and forcefully for the shareholders.

I have been troubled by these developments for many years. As a former board member of a major corporation myself, I have concluded that the malaise in much of corporate governance today has even deeper roots than the all too frequent lack of adequate shareholder oversight. Somehow we have come increasingly to substitute rules for *values*. We now look first of all to see if something is legal – satisfying the letter of the law, not necessarily its spirit.

Certainly we need rules to provide the framework for behaviour and ultimately to constrain those who would take advantage. But do we want a world based on rules or a world based on values? Rules will always have loopholes, and there will always be those who will spend their time trying to wriggle through them. This thinking appears to have invaded much of the corporate world.

Are our students today learning values or learning rules? I hope both, but with a good dose of the former. Because any set of rules alone, disconnected from the values which those rules are ultimately meant to reflect, is like a body without a soul. ■

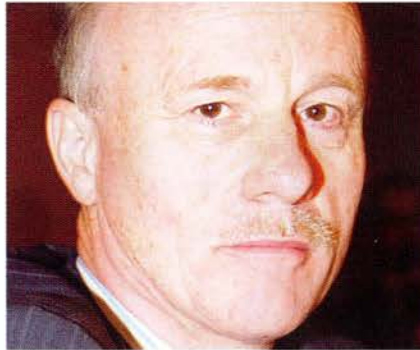
• News brief •

Terrorist cash top FATF priority

Combating terrorist financing is a top priority for the FATF "and we are calling upon all countries around the world to join us in this effort," new Financial Action Task Force (FATF) president Jochen Sanio said to mark the anniversary of the 11 September attacks on the United States.

More than 100 jurisdictions have taken part in a self-assessment exercise to evaluate the effectiveness of their measures to combat terrorist financing and the FATF encourages all those who have not yet done so to complete the self-assessment questionnaire. The FATF has also created a working group to deal with issues related to terrorist financing, such as abuse of non-profit organisations and wire transfer systems.

The FATF is holding a plenary meeting in Paris on 9-11 October to review progress by member and non-member states in adopting counter-terrorist financing measures in line with the FATF's Eight Special Recommendations on Terrorist Financing, adopted in the wake of the 11 September events.


©OECD
Jochen Sanio

Based on replies to the self-assessment questionnaire, it will identify countries that have not taken the required measures for follow-up assessment and/or technical assistance by the International Monetary Fund (IMF), World Bank and United Nations. ■

- For more information on the FATF's work: www.fatf-gafi.org

Safety in cyberspace

Growing worldwide dependence on information systems and networks makes it all the more important to protect these systems from cyberterrorism, computer viruses, computer hacking and other threats.

OECD governments have drawn up new guidelines to help create a "culture of security" for online networks in the wake of last year's 11 September attacks in the US, laying down nine basic principles covering areas such as security awareness and respect for ethical and democratic values. The guidelines urge all users of information technology, whether governments, business or individuals, to adhere to and implement these principles.

The new guidelines are non-binding but are the result of a consensus between OECD governments after discussions involving representatives of the information technology industry, business users and civil society. OECD governments and other participants will draw on them in establishing policies, measures and training programmes for online security. Governments in other countries are asked to adopt a similar approach, while businesses are asked to factor security into the design and use of their systems and networks.

Individual users are asked to be responsible and take preventive measures to lessen the security risks inherent in an interconnected world.

As a fitting indication of their popularity, within a short time of issue downloads of the guidelines caused a sharp jump in visitor traffic on the OECD's website. ■

- For the text of the guidelines and more information on OECD work on communications technology, see www.oecd.org/sti/security-privacy
- See "Security in the new economy" by Ian Gillespie and Taizo Nakatomi, *OECD Observer* 231/232, May 2002.

Steel agreement

Disagreements over steel protection have been a bone of contention between OECD countries for several months. Now, there may be agreement in sight as OECD countries have reached consensus on scrapping steel subsidies; it is a matter of agreeing on how to do so, and in particular, how to define what a subsidy actually is. A thorny question, but of a kind that the OECD is familiar with, Wolfgang Hübner of the science, technology and industry directorate told a news conference after a steel meeting in Paris in September. "Definitions are something that we in the OECD have wrestled with in other areas" such as shipbuilding, Mr Hübner said. "That is not a new problem, we will have to deal with it when the time is right". Government and steel industry representatives will meet again in Paris on 18-19 December to discuss definitions of steel subsidies. It will also be up to this high-level meeting to decide whether the steel talks should remain in the OECD, or perhaps be moved to the World Trade Organization once preparatory work has been done at the OECD, Mr Hübner said.

At a meeting at the OECD in April, steel producers had said they expect to cut capacity by some 91 to 95 million tonnes by the end of 2002, with an additional 23 to 33 million tonnes expected to be permanently closed by 2005.

- For more about OECD work on steel: www.oecd.org/enterprise/steel/

• News brief •

New OECD chief economist

Jean-Philippe Cotis has taken up the post of OECD chief economist and head of the economics department, replacing Ignazio Visco who had held the position since August 1997. Mr Cotis was previously director of the economics department at the French economy and finance ministry, a post he held since 1997. He has also previously worked with international institutions, chairing the European Union economic policy committee and the working party on policy aspects of macroeconomic and structural problems (WP1) of the OECD economic policy committee, as well as working as an economist at the IMF from 1986-1988. Mr Cotis' research work has mainly concerned labour markets, macroeconomic policies and taxation. In an interview with the media shortly after his appointment, the new chief economist spoke of his intention to link the strands of the organisation's structural and economic work more closely together. On globalisation, Mr Cotis is constructive, seeing it "not as an end in itself. Rather, the objective is well-being, and the better management of global public goods like health and education". Mr Cotis, 44, is married and has three children. ■

Jean-Philippe Cotis

Sharing views on energy

It is in the interest of energy producers and consumers to work together to meet the global energy challenges of the next few years, International Energy Agency (IEA) executive director Robert Priddle said at the launch of the latest *World Energy Outlook* report in Osaka, Japan in late September. "The messages in this book are of equal relevance to producers and consumers and the challenges it describes can be best met if we co-operate in tackling them."

Organisation of Petroleum Exporting Countries (OPEC) president Rilwanu Lukman echoed this view, telling an OPEC ministerial meeting in Osaka the same week that "we attach a great deal of importance to producer-consumer dialogue." Both Mr Lukman and Mr Priddle were in Osaka to attend the Eighth International Energy Forum. The two organisations had held their first joint press conference earlier in the month in Rio de Janeiro.

"The IEA is proud of its reputation as the energy watchdog of the industrialised world, and will maintain it," Mr Priddle told the press conference with OPEC secretary general Alvaro Silva-Calderon at the World Petroleum Congress. "We speak for oil consumers everywhere; but we also have major oil producers as our members. A good watchdog can see both sides of the fence."

The two organisations are both co-operating on an international Joint Oil Data Exercise, designed to bring greater transparency to oil markets by improving the quality of published data on oil demand, supply and stocks.

The latest edition of the *World Energy Outlook* projects trends in energy supply and demand, prices, trade and carbon emissions to the year 2030. It also includes a special chapter on energy and poverty (see Databank, page 52). ■

• IEA (2002), *World Energy Outlook*, OECD, Paris.

Dangerous driving

French President Jacques Chirac's recent horror at French roads being among the most dangerous in Europe was borne out by recent figures from the European Conference of Ministers of Transport (ECMT), which is based at the OECD. These show that while the highest number of road deaths in absolute terms in 2001 occurred in Russia, up 4.4% from a year earlier at 30,898, France came second, up 1% at 7,720.

Roads in western, central and eastern Europe generally became safer in 2001, with the number of road deaths significantly lower than in 2000, but in the Commonwealth of Independent States (CIS) the record worsened, with a 5.3% rise in the number of fatalities. The number of deaths on the road in western Europe fell by 3.9% in 2001, while fatalities on central and eastern European roads dropped more than 4.7%. But the overall death toll on European roads for the year still came in at more than 87,500, preliminary figures from the ECMT showed.

And performance varied widely between countries. The sharpest rise in road deaths was in Yugoslavia, up 21.5% from a year earlier with 1,273 people killed, followed by Ukraine, with road deaths up 13.5% at 5,900. The steepest increase in western Europe was Finland, with road deaths up 9.3% in 2001 to 433. Macedonia and Liechtenstein can claim the sharpest percentage fall in road deaths, down 34.0% and 33.3% respectively, although the actual number of people killed remained far higher in Macedonia (107) than in Liechtenstein, where just two people died. And Azerbaijan was the only CIS state to reduce its number of road deaths, down 6.2% at 559. ■

• See www.oecd.org/cem

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Corporate governance and responsibility
Foundations of market integrity

Bill Witherell, Head, OECD Directorate for Financial, Fiscal and Enterprise Affairs

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Good governance goes beyond common sense. It is a key part of the contract that underpins economic growth in a market economy and public faith in that system. The OECD Principles of Corporate Governance and Guidelines for Multinational Enterprises are two essential instruments for ensuring that this contract is honoured.

The recent spate of US corporate failures and breakdowns in truthful accounting has undermined people's faith in financial reporting, corporate leadership, and the integrity of markets the world over. The fact that the wave of scandals has come hot on the heels of a collapse in the high-tech bubble has a sharp ironic flavour. Both events have their roots in the heady days of stock market exuberance, when anything was possible, from creating multibillion dollar companies with little more than an idea, an investment angel and a lot of faith, to believing that markets would buy any yarn a group of fast-talking executives could spin, even if to cover up serious losses and illegal practices. The corporate scandals and the bursting bubble have different causes though: on the one hand, illicit management decisions and cover-ups, and on the other, over-bloated investment assessments followed by a sharp market correction that spelt the end for thousands of high-tech wannabes. Still, it is difficult to disentangle the negative effects these two parallel developments have had on the confidence of investors.

With the bursting of the high-tech bubble, share values were written down and venture capitalists took a bruising, as did many shareholders. That is the downside of committing resources to investments with a high risk/high reward profile. But in the cases of corporate misbehaviour, the public, employees and pensioners were deliberately misled. They have now lost many billions of dollars, and in some cases their life savings, while some insiders benefited. The truly unfortunate part is that both events might in their own way have been avoided (or at least anticipated) if effective corporate governance

and high levels of corporate responsibility had been respected.

The role of good governance and corporate responsibility in helping to assure the well-functioning markets needed for economic growth and development cannot be taken for granted. This idea has been repeated by government and business leaders the world over, and most recently reaffirmed at summits from Doha to Johannesburg. But we are falling short: the systems may be there – the US had, on paper, one of the best – but evidently they have not worked. Fixing them will require both private initiatives and strong government action.

Good corporate governance – the rules and practices that govern the relationship between the managers and shareholders of corporations, as well as stakeholders like employees, pensioners and local communities – ensures transparency, fairness and accountability. It is a prerequisite for the integrity and credibility of market institutions. By building confidence and trust, good governance allows the corporation to have access to external finance and to make reliable commitments to creditors, employees and shareholders. It is this contract that underpins economic growth in a market economy.

When this trust is undermined, lenders and investors lose their appetite for risk, and shareholders offload their equity, resulting in lost value and reduced availability of capital. This goes for every stage of the investment process, affecting issues from property protection and ownership registration, to disclosure and the distribution of authority and responsibility among company organs.

Clearly, the importance of good corporate governance goes far beyond the interests of shareholders in an individual company. Indeed, the central corporate governance principles of transparency and accountability are crucial to the integrity and legal credibility of our market system. We already trust corporations to create jobs, generate tax revenues and provide markets with goods and services. Increasingly we make use of private sector institutions to manage our savings and secure our retirement income.

Private participation in delivering these services has been proven to work, but it is constantly under scrutiny and must remain so. Some private pension funds, for instance, have recently been informing their pensioners of the prospect of reduced payments, due to falling stocks. If market risk and cycles were the only cause behind these announcements, that would be fine. The stakeholder public would probably live with that, and anyway, the market provides other instruments for customers to invest in, like property or long-term bonds. But to the extent that the market's fall can be traced to scandals and breaches of trust, public support wanes and the market becomes unworkable. The state's reputation is also at stake.

This underscores a widespread public – and hence political – interest in reinforcing corporate governance practices. Such concerns become even more important in an international context where the full benefits of free capital flows will only be realised if there is a mutual understanding on the basic elements of good corporate governance. These are the core concerns that triggered and nurtured the discussions on corporate governance in OECD countries, leading to the development of the **OECD Principles of Corporate Governance**. These principles, that have received OECD ministerial backing, form the basis of a true global standard in corporate governance.

We need to develop governance tools and incentive structures that are more robust in the face of rapid financial innovation, and procedures that leave no doubt as to the stakes involved. Accounting standards need to become principle-based, rather than being based on rules that invite evasion.

In the light of recent developments, OECD ministers have called for an assessment of these principles. The basic ideas enshrined in the principles are not being questioned, but there evidently is a need to provide further guidance, particularly with respect to achieving effective implementation in the dynamic markets of the 21st century.

Corporate structures change fast, while financial innovation and globalisation all present new challenges to maintaining good corporate governance. The recent high-profile cases of governance failure and corporate misconduct have shown that corporate governance mechanisms sometimes have not kept up with these developments.

The OECD principles already highlight that an annual audit of accounts be conducted by "an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented". The principle is there, but as we have seen recently, it was not always heeded. Governments, security market regulators and the private sector itself are all taking steps to strengthen the implementation of this principle.

Nor have company boards lived up to their responsibilities. For instance, the OECD principles recommend that the board "monitors and manages potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions". There is obviously a gap between risk management practices by corporations and investors and the existing tools for disclosing, accounting for and controlling risk. And monitoring is not easy, since the conflicts of interest that have been identified extend beyond the corporations themselves to financial analysts, rating agencies and financial institutions. In other words, who can we trust? We need to develop governance tools and incentive structures that are more robust in the face of rapid financial innovation, and procedures that leave no doubt as to the stakes involved. Accounting standards need to become principle-based, rather than being based on rules that invite evasion.

But while details and principles may be strengthened on paper, they will serve little purpose without the political commitment to abide by them. The aim is to reinforce the contracts of trust that drive our market democracies; governments as custodians must take a lead in ensuring these contracts are not only understood, but honoured too.

Responsibility

Corporate managers' responsibilities, of course, are not limited to producing truthful financial reporting, carrying out the core functions of conducting business and obeying the various applicable laws. Businesses also have to respond to the expectations of the democratic societies in which they operate – expectations that often are not written down as formal law. The term "corporate responsibility" refers to the actions taken by businesses in response to such expectations in order to enhance the mutually dependent relationship between business and societies. Shareholders, in fact, expect their corporations to meet society's demands, consistent with maximising the value of the firm. Indeed, experience has shown that companies that do so are generally the best performers in the long run.

The challenge of meeting these expectations has become more complex in today's global economy, with firms typically operating in a number of legal, regulatory, cultural and business environments. Globalisation's benefits are well documented, but it has raised legitimate public concerns, several of which have been directed at multinational enterprises as agents of the globalisation process. Multinational enterprises sometimes are perceived as taking the money and running, not doing enough to build up local economies, and so on. They are accused of being party – in many cases, inadvertently – to serious problems such as corruption of public officials, human rights and labour rights abuses and environmental damage. Companies have to address such concerns when they arise. In fact, apart from ethical considerations and the law, their host-country market valuations would suffer if they ignored them.

In recent years, businesses have engaged in voluntary initiatives to improve their performance in various areas of business ethics as well as legal compliance. They have developed codes of conduct and management systems designed to help them comply with these commitments. They have developed them with the help of labour unions, non-governmental organisations and governments.

The recently updated OECD **Guidelines for Multinational Enterprises** complement and support these private initiatives for corporate responsibility. These guidelines are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. Being from the OECD is somehow appropriate, given that nearly all FDI that takes place in the world originates and is financed in the OECD area. In fact, the MNE guidelines are the only multilaterally endorsed instrument for corporate responsibility and reflect extensive consultation with countries outside the OECD, as well as business and civil society. They cover the full range of areas relevant to standards of responsible business conduct and so provide to corporations a most valuable international benchmark of society's expectations (see article, p.10).

Further improving the "fit" between corporations and the societies in which they operate is a key goal of the OECD. That means strengthening the governance structures and practices within corporations, and their relationships with shareholders and other stakeholders. Good corporate governance and corporate responsibility are no longer add-ons to markets; they are integral to them. They are the basis on which public-private partnerships can grow. The OECD is determined to lead the way. ■

End of an affair?

An opinion poll in *BusinessWeek* magazine shows half of the US believing that what is good for business is not necessarily good for their country. Hardly surprising, you might think – except that the poll was carried out over two years ago, before the high-tech bubble burst and well before the recent corporate scandals. And the fact that the opinion poll was in one of the US's main pro-business magazines meant that the results simply had to be taken seriously.

They were also quite unexpected. The *BusinessWeek* poll was wide-ranging, with respondents asked to agree or disagree with several given statements. The one that made the headlines was simple: in general, what is good for business is good for most Americans. Some 47% of respondents agreed with that statement, but 49% disagreed. This was much more negative than the previous poll conducted in 1996, when just 28% felt their interests and those of business were not necessarily the same. Another finding to ruffle corporate plumes in the 2000 survey was that 72% of respondents agreed that business had gained too much power over too many aspects of American life.

It was not all bad news for corporate America. Indeed, 68% of respondents agreed that American business should be given most of the credit for the prosperity that prevailed during most of the 1990s. However, one question might make worse reading if the poll was conducted today: when asked how much confidence they had in those running big business, only 19% had a lot of confidence, though as many as 58% had at least some.

Opinion polls have their limits, though the *BusinessWeek* survey at least suggests that, probably because of a backlash against globalisation as demonstrated at Seattle in 1999, the public image of corporate America was looking tarnished well before the scandals that erupted at Andersen, Enron and elsewhere. These scandals appear to have transformed that disillusion into a crisis of confidence.

Is it the end of the affair between America's public and its business world? Probably not, though a more demanding public will mean the relationship may never be quite the same again. There is a coincidental footnote to add to this story: the issue of *BusinessWeek* in which this rather astonishing opinion poll appeared was dated 11 September, 2000.

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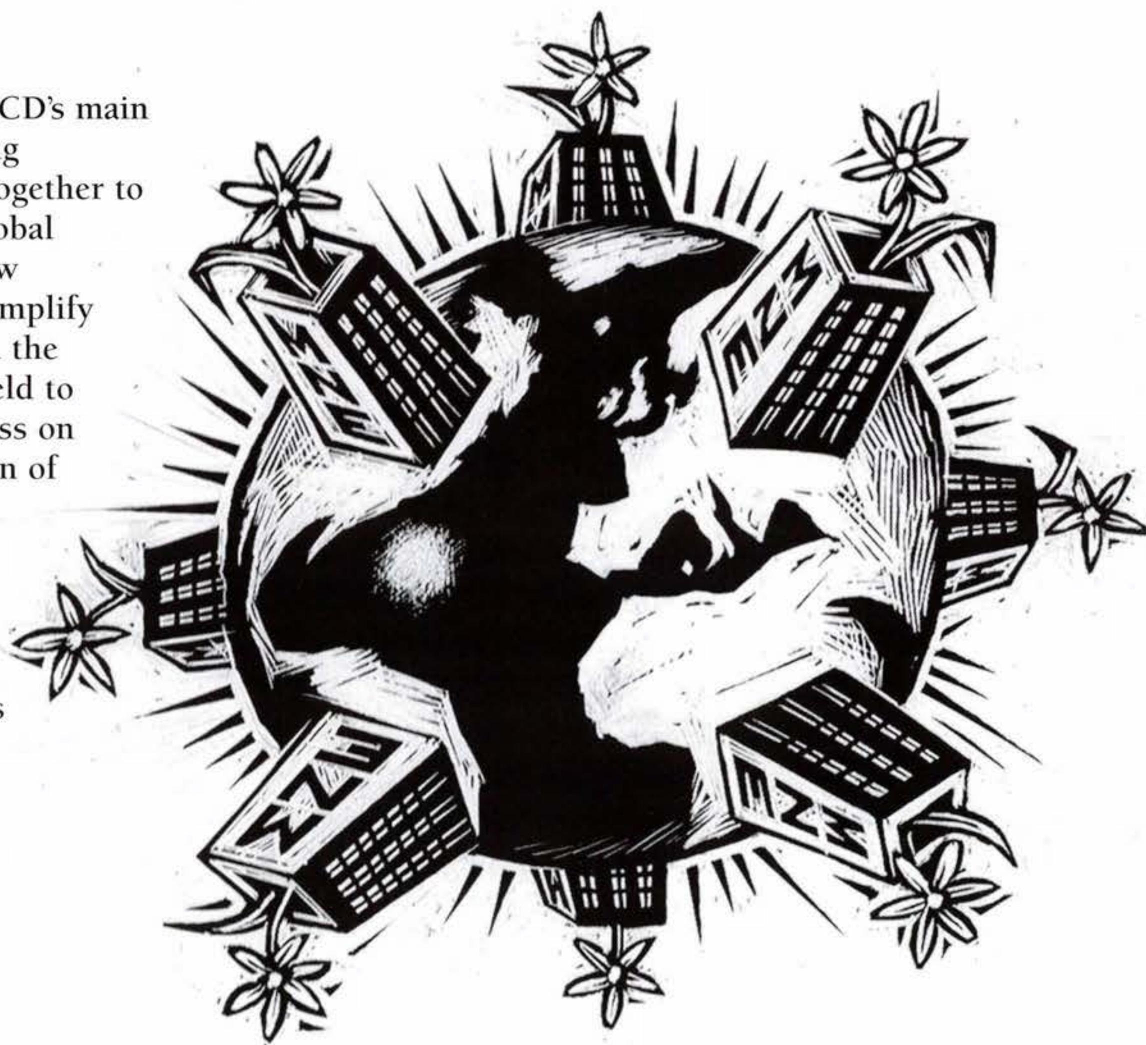
The supply chain: a key link for better governance

One of the OECD's main roles is to bring stakeholders together to discuss key global challenges. Few gatherings exemplify this more than the roundtables held to discuss progress on implementation of the OECD Guidelines for Multinational Enterprises. The most recent one was held over the summer.*



Globalisation has given rise to a kind of economic "culture shock" and international business is one of the principal sufferers. Tens of thousands of companies are trying to conduct business in a global mosaic of legal, regulatory, business and social environments. Operating in all of these environments and responding to their diverse expectations of corporate behaviour is a formidable challenge, in particular as public (and market) pressure becomes more intense. Many companies have taken positive steps by introducing corporate codes, embracing multilateral principles and so on, yet, according to participants at a recent roundtable on the OECD Guidelines for Multinational Enterprises there is much more to do.

Take a recent study of the results of audits of 300 supplier establishments operating in poorer countries that was financed and published by a group of leading French retailers. In the view of Neil Kearney of International Textile, Garment and Leather Workers' Federation "the details make grim reading" – children under 13 hard at work, non-compliance with minimum wage laws, working weeks of "86 hours or more", "inadequate" occupational health and safety conditions, "endemic" abuse of workers' rights, including suppliers using physical force to prevent workers

from exercising their right to organise. Other documents highlighted obstacles to organising labour unions and the presence of children in the supply chains of major agrifood companies. These are probably exceptional cases and most good corporations would not tolerate them, but where they exist, all would agree they must be taken seriously.

The OECD roundtable's theme was supply chain management. It showed the advantages and difficulties of multistakeholder cooperation. For while all participants, whether government, business, labour or civil society groups, clearly cared about the problem, they had different views on how best to tackle it. Business generally argues that the key lies in better supply chain management to alleviate poverty and improve respect of human rights, others see tighter regulation and surveillance as the only way to achieve progress. Deborah White of Proctor and Gamble said the business community was committed to finding answers, and while André Driessen from the Confederation of Netherlands Industries and Employers underscored the business sector's willingness to co-operate with unions, NGOs and governments to search for solutions, Stephen Canner of the US Council for International Business noted that governments have to act too as "there are limits to what companies can and cannot do". Others countered that while governments clearly had an important job to do, lack of government responsibility "is not an excuse for lack of corporate responsibility".

Can domestic law help? Yes, but it is not enough. Some countries like China, as Serena Lillywhite from Brotherhood of Saint Laurence, an NGO that inherited a small business, noted, set certain labour standards and rules that matched those of many OECD countries, but their enforcement was lacking. International declarations on labour and human rights, and standards and principles such as those from the OECD help to fill that vacuum, as do corporate codes of conduct and other private standards issued by labour unions and NGOs.

Business representatives stressed their view that corporate responsibility in the supply chain could not extend to "taking on" other companies' problems – in particular, their legal or regulatory responsibilities. Companies exist as discrete units for reasons of economic efficiency and legal accountability, they said. In any case, it is not economically or logistically feasible for all enterprises to monitor and audit all their suppliers.

Companies exist as discrete units for reasons of economic efficiency and legal accountability, business representatives said. It is not economically or logistically feasible for all enterprises to monitor and audit all their suppliers. This position sparked a reaction

This position sparked a reaction. Carol Pier of Human Rights Watch argued that when companies fail to use their influence over their suppliers' regarding respect of labour rights, these companies are complicit in those human rights violations. Ineke Zeldenrust of the Clean Clothes Campaign was pragmatic in stressing responsible supply chain management and the need to "break it down … and look at how it (supply chain management) can be operationalised."

Monitoring the guidelines

Roundtables like this one on MNE supply chains are held annually at the OECD in conjunction with meetings of the National Contact Points (NCPs). These have been set up in 37 countries to monitor the implementation and efficacy of the MNE Guidelines and to promote awareness of them. Promoting the Guidelines is important, since standards and principles, however eloquent or tough to negotiate they may be, are quite powerless unless as many people as possible know about them. The MNE Guidelines are now quite well known by business, unions and civil society in some countries and are featured on many websites. But as reports from the NCPs show, they are hardly known at all in other countries.

Yet, if the MNE Guidelines succeed in winning the confidence of business, trade unions and NGOs, they could become one of the most important global initiatives for global corporate responsibility there is, bolstering such instruments as the UN Global Compact. The OECD, as home to most of the world's multinationals, can and must win that confidence.

The NCPs have already begun to bring material on specific cases for investigation, of which there are now over 20. These involve consideration by adhering governments of issues that go to the core of the debate on globalisation, whether it be behaviour of French companies (there were two) in Burma, a Canadian company's "resettlement" problems in the Zambian copper belt, occupational health and safety and accident indemnities for Indonesian and Philippine sailors working for OECD based maritime transport companies, a Korean-run production site in Guatemala or even a UK retailer's behaviour elsewhere in the OECD.

No one has a monopoly on the answers, but it is only by knowing and understanding the problems face on, and working together to deal with them that corporate responsibility will improve. After all, whether the goal be sustainable development, poverty reduction, equitable rights or just plain decent ethics, better business behaviour is in everyone's interest. ■

The OECD Guidelines for Multinational Enterprises can be consulted at www.oecd.org/daf/investment. Detailed accounts of the proceedings of this roundtable are available on request at daf.contact@oecd.org or at observer@oecd.org.

** Views expressed by participants at the roundtable are not necessarily shared by the OECD or its member governments.*

Knowledge in a world of risk
Forging a global corporate citizen

Young Chul Kang, Managing Director, World Knowledge Forum Secretariat

Can we promote ethical and responsible business practices and make financially successful companies in the process? Yes.

After the accounting debacles of Enron and WorldCom, the credibility of large companies hit rock bottom. In a bid to restore confidence, the US authorities now require chief executives and chief financial officers of large listed companies to swear to the truth of their financial statements. The chief executive officer (CEO) and chief financial officer may be charged with civil and criminal offenses if any of their financial statements are found to be false.

If only the problem were confined to the US, but it is not. The same kind of problem has arisen in Korea, where recent accounting fraud in venture companies listed on the Korea Securities Dealers Automated Quotations index (Kosdaq), the Korean equivalent of the US Nasdaq, caused the index to plunge to a mere 53 on 19 September 2002 from a high of 279 on 15 December 1999. The CEOs of 810 companies listed on the Kosdaq have made voluntary pledges to ensure accurate accounting. Although these pledges are not legally binding, the list of participating companies will be publicly announced and a company's image risks being severely damaged if it fails to uphold its promise.

Such events bring home the fact that as globalisation proceeds at a fast pace, companies in different countries are being scrutinised in relation to the same set of principles and guidelines. To survive, it no longer matters whether a company is an international or a domestic player. It still has to comply with what are internationally accepted as the "right" principles of corporate ethics and governance.

Companies are being made to act as responsible citizens of this global society, and they could be severely sanctioned, not just by the market but by legislators, should they be seen to fall short of their duty of making a good and honest profit for shareholders and keeping clear, accurate and open accounts to prove it.

How can we promote ethical and responsible business practices and thus help make financially successful companies in the process? And how should the concepts of corporate ethics and social responsibility in the 21st century knowledge society differ from those of the industrial era of the 20th century?

In order to implement corporate citizenship globally, it is essential to

A jubilee of human knowledge

The theme of the third World Knowledge Forum (WKF) is "Knowledge in a World of Risk: A Compass towards New Prosperity".
"We like to define the World Knowledge Forum as a 'jubilee of human knowledge'," says the WKF website (www.WKForum.org). "Evolution," it says, "refers to steady, predictable change. Revolution – like a rugby ball in which we cannot predict the direction of the next bounce – is all about disruption, discontinuity, instability, and unpredictable change. Could this be deemed as a threat? Or opportunity?"
The World Knowledge Forum takes place in Seoul, Korea on 15-18 October. This year's speakers include OECD secretary-general, Donald Johnston; World Bank Human Development Network managing director, Mamphela Ramphele; and 2001 Nobel economics laureate, Joseph Stiglitz.
Governance issues figure highly on this year's agenda, in particular at the OECD's plenary session on "Sustainable Globalisation: Politics, Money and Trends". Bill Witherell, director of the OECD Directorate for Financial Fiscal and Enterprise Affairs, and William Davie of Schlumberger, are among the speakers.

- Visit www.WKForum.org

stick to one global standard, especially in the field of management practices. By this, I mean that one should not fool oneself by practising double standards. In Korea, an international globally renowned brokerage firm was recently sanctioned by the authorities for leaking an internal report on Samsung Electronics to its customers prior to publication. This "accident" could have been avoided if the company had adhered to the core operating principles that it abides by in other markets. These brokers may try to defend themselves by arguing that this is a common practice among some Korean analysts, but it is this sort of act that may hinder the development of a global standard of corporate citizenship. It also gives ammunition to the anti-globalisation activists.

Some corporate leaders of multinational companies based in developing countries may argue that they would be unable to compete with domestic firms if they had to follow the strict code of ethics set by their headquarters. Clauses strictly prohibiting kick-backs, bribery or undue profits from abusing insider information make it difficult for their business to survive, they say. However, one can cite several model practices from all over the world that demonstrate the execution of global management standards. Johnson & Johnson is a pharmaceutical company that now runs immensely successful operations in Korea while following to the letter the severe code of ethics imposed by its US headquarters. Johnson & Johnson's management have steered clear of untoward practices and still manage to run a successful business.

To implement corporate citizenship globally, it is essential to stick to one global standard, especially in the field of management practices.

Codes of ethics or corporate citizenship must be observed wherever a firm does business anywhere in the world. Corporate governance is a key element of this equation, and may help us to more quickly reach the goal of global corporate citizenship, where we can be sure that all companies operate to the same standards wherever they are doing business. ■

Global corporate citizen

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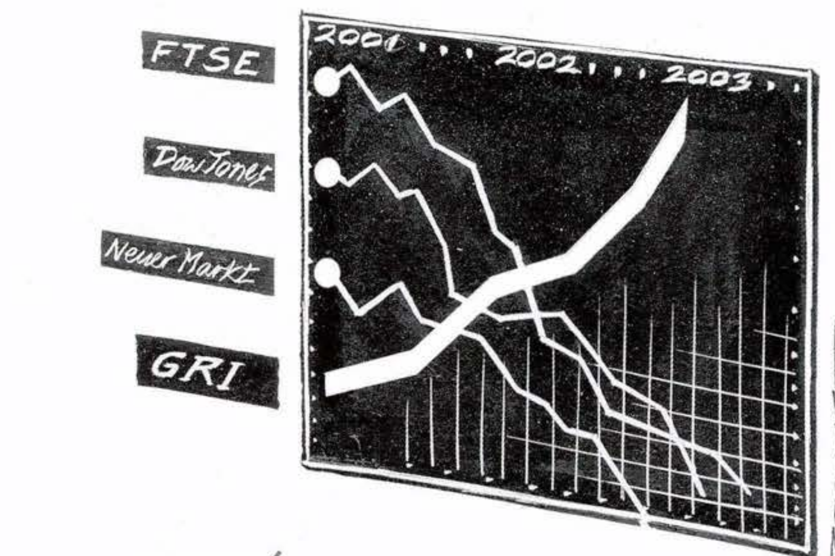
Redefining corporate disclosure

Allen L. White, Acting Chief Executive, Global Reporting Initiative

Improving corporate behaviour is vital to sustainable development. The Global Reporting Initiative can help show the way.



The current crisis in confidence over corporate financial reports raises questions that go well beyond a company's financial sustainability. Business failures provide a vivid reminder of how fundamental corporate activity is to the lives and livelihoods of people and communities worldwide. As shareholders, institutional investors, trade unions and policymakers take stock of the social repercussions of the Enron and WorldCom affairs, and with the UN World Summit on Sustainable Development (WSSD) still fresh in our minds, it is time for governments to address the limits of financial reporting.

By most assessments, there were two main elements underlying the events that have prompted widespread calls for a higher ethic of corporate responsibility. The first was a failure of accounting systems. The second was a breakdown of corporate governance. Business collapses in recent months were in part attributable to poor audits of required information. But, equally important, they resulted from a fundamental reality of financial reporting: even sound numbers that comply fully with required standards do not deliver all that shareholders and others need to know to assess the true health of a corporation.

As they currently stand, financial reports meet certain narrow technical requirements and provide a glimpse of past performance – last quarter's earnings or last year's revenues. But what about the future? Where is the information on the firm's capacity to innovate, train and enrich its human capital, enhance its reputation, strengthen brands, alliances and partnerships? And what about measures of public trust and the quality of governance?

All these intangible assets, if reported at all, appear in non-comparable and inconsistent form. This is the reality, even though the markets clearly signal the growing importance of such intangibles as critical underpinnings of value in the marketplace.

The long-term sustainability of corporations rests on a complex balance of factors. While financial viability is clearly vital, so too are elements such as the ability to adapt in a changing market; to maintain official and public trust; to attract and inspire a workforce; and to retain and expand the support of local communities and the client base.

But financial accounts rarely assess the full environmental impact of a company's activities or products. Nor do they weigh up how its human resources policies may influence the workforce, or how public opinion about its social and human rights record may affect consumer attitudes to its products. This is starting to change, as many corporations seek ways of measuring their so-called "eco-efficiency" performance. They are doing this by using

"sustainability reports" as an adjunct to their financial statements.

The concept of "triple bottom line" reporting, such as that offered by the Global Reporting Initiative (GRI) – an assessment of a corporation's performance in relation to profit, people and the planet – is increasingly welcomed by financial analysts and investors because it helps them make better judgements about the true value and prospects of a company across a broader range of assets. Moreover, it enables management to anticipate and exploit opportunities to strengthen the firm's market competitiveness and boost company transparency.

Whether firms like it or not, a company's non-financial performance can directly affect its financial health too. The link between human rights or environment and share value is already well-documented. Four of the world's major stock markets – New York, London, Hong Kong and Johannesburg – have implemented or are proposing changes to disclosure rules that will require information on corporate governance, environmental liabilities, HIV/AIDs programmes, and human capital issues from basic working conditions to policies on child labour. This development signals a growing recognition that non-financial information linked to sustainability performance is an essential ingredient in forecasting and securing a company's financial prospects.

Fortunately, a variety of tools are now available to make possible an ever-closer alignment between enhanced financial reporting, sustainability reporting and principles of corporate governance. With the release of its 2002 *Sustainable Reporting Guidelines*, the GRI provides a flexible mechanism for such enhanced reporting, offering a detailed methodology for performance disclosure. The GRI guidelines can be seen as complementing other instruments, like the OECD Guidelines on Multinational Enterprises and its principles of corporate governance, which guide good business practice. The GRI guidelines have been developed since 1997 in a consultative process involving thousands of representatives from the business, accountancy, labour and NGO sectors around the world. They provide a ready-to-use, consistent and comparable framework designed to reinforce traditional financial reporting.

What kind of information do new GRI-based reports contain? Companies that use the guidelines will report on a broad array of issues, including corporate governance; financial flows from the company to the community where it operates, including taxes, payments, salaries, etc.; materials and energy use; and carbon emission and biodiversity. The reports will also cover labour practices and human rights; bribery and corruption policies; and product stewardship (how the company handles its responsibility for the whole product life cycle and supply chain).

Knowing, for example, how much greenhouse gas a company is producing is important not only for the environment, but also for shareholders, especially if such emissions are taxed or subject to carbon trading. In the same vein, corporate governance is no longer an arcane issue relevant only to boards of directors. It is fundamental to the very survival of the firm and to the well-being of its workers, suppliers and communities.

Non-financial information linked to sustainability performance is an essential ingredient in forecasting and securing a company's financial prospects.

The fact that GRI guidelines are now used by more than 150 companies worldwide, including ABB, General Motors, Royal/Dutch Shell, Eskom, Rabobank, South African Breweries, Nissan and Ford, underlines the growing recognition of this reality. As the business case for sustainability reporting is further articulated and understood, the number of companies issuing GRI reports is likely to reach thousands within a few years.

Sustainability cannot be reached without the robust and focused input of a healthy business sector, working in close collaboration with governments and the rest of civil society. At the Bali preparatory meeting for the WSSD in June 2002, ministers specifically agreed, in the draft Plan of Implementation for the summit, on the need to enhance corporate environmental and social responsibility and accountability, "taking into account such initiatives as ...the Global Reporting Initiative guidelines on sustainability reporting...".

As was evident in Johannesburg, there is a near-global consensus that companies should go beyond financial philanthropy and apply their expertise and technology to solve social problems.

Judging from media reports and public opinion polls, the level of public trust in corporations is at an all-time low. The disruption and loss to workers, investors and communities associated with the recent corporate failures have taken a severe toll on economies and societies. Not only is there a clear sense that corporations have a responsibility to provide a full and more accurate account of their financial situation, but also that they must make more earnest efforts towards sustainability if they are to win back public support. This is clear from widespread calls by major NGOs for an international, legally binding mechanism to hold transnational corporations accountable for their behaviour.

Governments must make every effort to assist businesses to meet these challenges. The GRI Sustainable Reporting Guidelines can play a vital role. ■

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Better governance for sustainable business*

Philip Watts, chairman of the committee of managing directors, Royal Dutch/Shell group and chairman of the World Business Council for Sustainable Development

©Peter Mueller/REUTERS

Cleaner image

Sustainable development is not against business interests. In fact, business can profit from it.

Ten years ago at the Rio Summit, 50 business leaders pledged a commitment to sustainable development. That was the start of the World Business Council for Sustainable Development (WBCSD). Since then, we have trebled in size and hugely amplified the voice of business in widespread dialogue.

Business is good for sustainable development, and sustainable development is good for business. It should be at the heart of business thinking and government policymaking.

What does that mean? Well, it means tough choices and new thinking. For instance, you choose to work by a set of declared

principles and to stick to them whatever the circumstances.

You say "no bribery of any kind". You make sure it's clear to everyone that you mean it and if anyone goes against it you ask them to leave. If you can't win business without bribes you go without. If necessary you leave the country or you get out of joint ventures – even if there are short-term financial hits.

You set environmental standards and keep to them. If you have an important project that is likely to fail those standards, you tell your people "no go" unless they find ways to get the environmental element in line. You'll be amazed at the innovation a challenge like that can unleash. If they can't do it, you leave it.

You put people and communities in the frame. If you are working in a developing country and your staff take it for granted they will use the usual international contractors, tell them to think again. Make it the norm to find local firms, build local capacities.

I can hear you thinking "that's the best way to lose business, to lose out to competition, that I've heard in a long time." Not so, in the long run. Once people know you won't bribe, once you make eco-efficiency

We need partnerships for progress between business, governments and civil society, and we need them urgently.

standard practice, once you have developed local, more cost-effective, contractors, your competitive edge will be enhanced.

Care for the environment and social justice should be an integral part of the economic development that funds progress. Demonstrating this in action helps us meet societies' expectations, and that is an increasingly important part of our commercial challenge. Being seen to share societies' concerns attracts and motivates people to join and stay with a company. Equally, it boosts that company's reputation with a range of interested parties who will often be opinion leaders.

In my view there is no doubt that economic, social and environmental improvement is best nurtured in open, competitive international markets where governments set stable and pragmatic frameworks for business investment. However, the benefits of markets must be extended further towards the world's poor.

Briefly, one of the keys to sustainable progress in developing countries is foreign direct investment (FDI). But only about 5% of FDI goes to the 40 least developed countries. If that investment is to increase, especially in Africa, there must be an emphasis on establishing good governance, stable regulatory systems, pragmatic economic policies and accountability mechanisms.

But investment alone is not the answer. Linked to it is the challenge of developing Africa's human and natural resources to the African peoples' advantage with minimum adverse impact. We need partnerships for progress between business, governments and civil society here, and we need them urgently. For me, it's just as urgent for business to take on board the essentials for pursuing sustainable development. Let me highlight a few of them.

We have to learn to change. We need to stimulate innovation that allows us to create wealth in ways that reflect changing concerns and deep-seated values. We should be taking on eco-efficiency as a management strategy – seeing how we can create more value with less impact in terms of energy and material. And we should be informing consumers about the environmental and social effects of the choices we offer them.

We have to demonstrate action to remain credible. That's why the WBCSD is developing initiatives on sustainable mobility and sustainable livelihoods. And why we are partners in a project to make this summit "climate-neutral".

Sustainable development isn't an easy option. We need to support each other, to share problems, experiences and ideas. That's the aim of two recent publications.

The first sets out the WBCSD's blueprint for action. It's called "Walking the Talk" and it illustrates the argument with 64 case studies. Ten years after Rio we know we are on a tough journey of continuous learning. WBCSD members see action to build a sustainable future as part of their commercial responsibilities. But

If you can't win business without bribes you go without. If necessary you leave the country or you get out of joint ventures – even if there are short-term financial hits.

we can pursue that most effectively in partnership with governments, political leaders, NGOs and international bodies.

The second comes from Shell and it's a collection of sustainable development case studies from around the world – from working for biodiversity in Gabon to pioneering cleaner fuel in Thailand, from community development in Nigeria to reducing gas flaring in operations there. It is called "There is no Alternative".

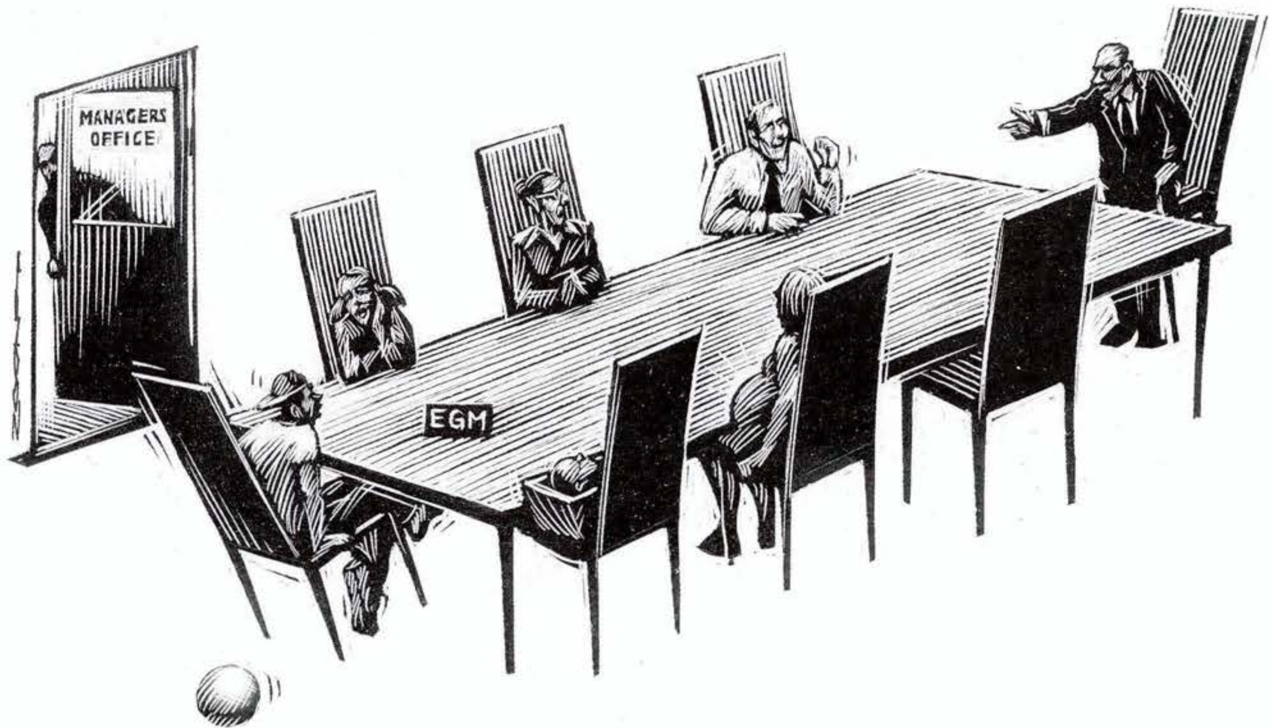
We need more initiatives like the partnership in China with the United Nations Development Programme (UNDP) on the West-East gas project. This project will be built by a joint venture with Chinese and international involvement.

The UNDP has carried out a survey to better understand the likely social impacts on people who live along the route of the pipeline. It will be part of the decision-making process. That kind of independent consultation gives invaluable input and helps avoid future, often costly, problems. ■

** This is an extract from a speech given during the Business Day at the World Summit on Sustainable Development in Johannesburg, 1 September 2002. Mr Watts has also participated in the OECD Round Table on Sustainable Development. More by Mr Watts can be found at www.shell.com*

When corporate governance is a family affair

Robert Zafft, OECD Directorate for Financial, Fiscal and Enterprise Affairs



Family-run firms tend to believe that principles of good corporate governance do not really concern them. This is a mistaken view. The question is how to convince them.

Corporate governance has become an industry – and a growth one at that. Conferences spring up like mushrooms after rain. Technical assistance money gets spread around like so much fertiliser, and acres of rain forest end up as expert papers on "new and improved" corporate-governance frameworks. Policymakers and investor groups seem to love it. But do the real decision-makers – business owners and managers – actually need or want corporate governance, and, if not, why should we expect them to buy into it?

Most corporate governance experts concentrate their attention on divergent incentives of managers and shareholders. Disclosure rules are intended to stop managers from inflating company performance. Boards of directors are established to guide managers' business strategy, to monitor their reporting systems and to ensure that managers do not overpay or entrench themselves at shareholder expense. In general, the corporate-governance world pictures owners and managers as sitting on opposite sides of the table.

But what happens when the owner is the manager? This situation is more widespread – and more relevant to large companies – than many might think. Family-run businesses account for more than 85% of all firms in OECD countries. Such businesses make up 30-40% of the 500 largest companies in the United States. The 30 OECD member countries contain at least 244 family-run firms with annual revenues of more than US$1 billion, not counting giants like Microsoft or Berkshire Hathaway that are still managed by their founding generation. OECD family-run businesses with annual revenues of several million dollars probably number in the tens of thousands.

In a family-run firm, a single person or group enjoys a controlling interest and can

appoint family members as managers, or can unilaterally appoint, monitor, compensate and fire third-party managers. This situation may threaten minority shareholders with exploitation, but offers the controlling family the best of both worlds: it can run the business as it sees fit and gamble, at least partly, with other people's money. As a consequence, if the purpose of corporate governance is to constrain managers and control shareholders, one may well ask whether a family-run firm would ever really want it.

The answer to this question is "yes", but not necessarily for the reason most commonly given: better access to capital. One often hears the argument that, when investors refuse to put their money in companies with bad governance, the cost of capital for such companies goes up, making them uncompetitive. Eventually, so the argument goes, the owners/managers of such

While the founder of a family-run firm might believe that raising money or diversifying wealth will never pose a problem, one thing he does know for sure is that some day he will die.

companies must either mend their ways or go out of business.

But firms can obtain external financing in a number of ways besides issuing shares to the public, such as reinvesting profits, borrowing money or selling shares through private placements.

In such cases, providers of non-public sources of capital (banks, pension funds, insurance companies, venture capitalists, private-equity investors, etc.) expect to look out for themselves. They will want to secure their loans with company assets, to be able to accelerate repayment of loans if the company's performance falters, and to review books and records directly. They will seek direct assurances from the company's auditor and officers, or personal guarantees from the company's owners. They will demand the right to approve major transactions or money transfers. For these capital providers, typical corporate-governance practices, such as board review of transactions between management and the company, board committees, non-executive directors, or separate CEO/board chairmen, hold little interest.

Data on family-run firms raise additional questions about the access-to-capital argument. Of those 244 OECD family-run firms with revenues of US$1 billion or more ("large firms"), only half are publicly traded. At the same time, the average ages of publicly traded and privately held large firms are about the same, suggesting that large private firms have been able to access sufficient capital without inevitably "evolving" into publicly traded firms.

This observation is bolstered by European data showing that the average company operates for 40 years before going public, and that when such a company does go public, nearly 60% of the money raised from its initial public offerings goes into the pockets of family shareholders rather than into the business. In many cases, therefore, wealth diversification or liquidity may be a greater issue for family-run businesses than financing operations.

Studies indicate that the stronger a country's corporate governance, the more robust its capital markets and the higher its level of external financing as a percentage of GNP. However, while these findings may persuade policymakers, at the level of the individual family firm the slogan "embrace corporate governance in order to access capital" can remain a tough sell.

Fortunately for the corporate-governance industry, a compelling case for corporate governance can still be made, and it involves the greatest challenge family-run businesses face: management succession. Succession issues resonate strongly with business owners. While the founder of a family-run firm might believe that raising money or diversifying wealth will never pose a problem, one thing he does know for sure is that some day he will die.

Will his children be interested in running the business? Will they be capable? Will they get up as early, stay as late, and work as hard as the founder did?

Keeping a business going across generations is hard. In fact, North American and UK studies indicate that only about one in six family-run firms survives to the third generation. Failure to maintain the family business can stem from any number of causes. Divisions form between those relatives enjoying both salaries and dividends and those receiving only dividends. Jealousies emerge as some family employees rise higher than others or work less hard for the same pay. Supervisors find themselves incapable of firing an under-performing subordinate who is a child or a sibling or a cousin.

As the business grows and markets evolve, finding sufficient managerial talent and experience within the family becomes harder. Where the family decides at last to hire an outside manager, failure to motivate and monitor him can damage or destroy the business.

Corporate governance goes to the heart of these problems, though many family-run firms have never thought of it in these terms. Families need corporate governance both to operate the business and to promote family harmony. This means putting in place decision-making and monitoring procedures that are open and fair, as well as possibly hiring non-family members as advisors, managers and directors.

It is not an overnight exercise, and often, by the time the need for corporate governance has been recognised, family relationships or the business's prospects have deteriorated beyond repair.

Family-run businesses can represent the work – and the wealth – of several generations. If business owners want to preserve, enlarge and pass on this legacy, they need to make corporate governance a family affair.

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Globalising workers' rights

John Evans, General Secretary, Trade Union Advisory Committee to the OECD (TUAC)

More could be done to strengthen the OECD Guidelines for Multinational Enterprises to ensure global workers' rights receive the attention they deserve in policy and business decision-making.

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Globalisation has drawn serious attention to the importance of core workers' rights on a global basis. There is a strange paradox in the treatment of labour when it comes to mainstream debates about globalisation. Surveys on foreign investors' intentions suggest that in most sectors market access, good governance, skills and education levels are more important in attracting investment than low wages or submissive workers. Yet rather than improving living and working conditions, globalisation appears to pressure governments into reducing workers' rights to minimise labour costs and attract foreign investment.

Take export-processing zones (EPZs) where semi-manufactured or raw materials are processed into goods for export by foreign companies, outside the normal laws and regulations of the host country. They may operate very differently in different parts of the world, but they tend to have one overriding characteristic in common: trade unions are tolerated in few, if any, of them. This is disturbing. An update in 2000 to an OECD report on trade and labour standards noted that the number of EPZs worldwide had risen from some 500 in 1996 to about 850, not counting China's special economic zones. EPZs have become commonplace in many parts of Asia and Central America and are now spreading to Africa as a development model.

Multinational companies may also simply decide to switch country, or at least threaten to do so, when faced with labour dissatisfaction or the prospect of a cheaper labour market, and this in good as well as in hard times. A study by Cornell University in 2000 found that, despite the longest boom in US history, workers were feeling more insecure than ever before. More than half the firms surveyed, when faced with union action, had threatened to close the plant and move to another

country. In some sectors, the figure rose to 68%. The fact that only 5% of firms actually moved away does not lessen the perceived risk of the threat, increasing the imbalance of relative power of unions and employers in the labour market.

The trade union response to globalisation must be to ensure that, in terms of labour conditions, we start a "race to the top" and stop the "race to the bottom" between multinational companies. At the level of TUAC, we are giving priority to maintain and encourage enforcement of the OECD Guidelines for Multinational Enterprises, revised by governments in consultation with labour unions, businesses and NGOs in 2000. The guidelines are recommendations for good corporate behaviour, primarily addressed to corporations based in countries that adhere to them but applying to their operations worldwide, that cover 85% of total foreign direct investment.

The MNE guidelines may not be binding in a legal sense at the international level but they are not optional either. If companies could simply pick and choose among the provisions of the guidelines or subject them to their own interpretations, then the guidelines would have no value. Nor does their application depend on endorsement by companies. The OECD's MNE guidelines are the only multilaterally endorsed and comprehensive rules that governments have negotiated, in which they commit themselves to help solve problems arising with corporations. Most importantly, the ultimate responsibility for enforcement lies with governments. This makes the guidelines more than just a public relations exercise.

To judge by experience of the past two years since the MNE guidelines were revised, we have made some tentative assessment of how they are functioning in practice and what can be done to improve their implementation. One problem is that probably still less than half of the signatories of the OECD guidelines have really functioning National Contact Points (NCPs), which are meant to vet the implementation of the guidelines. Though an improvement on the situation before 2000, we have still not arrived at a critical mass of governments who take their responsibilities seriously.

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Another problem is that the guidelines still need to be better known compared with other instruments, like the UN Global Compact. Within TUAC we have organised a project to raise awareness among trade unions, including a users' guide for trade unionists which is now available in several languages. With our partners, we are running workshops and seminars on the guidelines, particularly in non-OECD countries. But we feel governments could do much more. Also, although cases are now appearing before NCPs, they are often being dealt with very slowly. Of the 20 cases which have been raised over the past year by trade unions, as of June 2002 only five have been resolved or have led to recommendations being issued.

One might ask whether the OECD could not devote more resources to the implementation of the MNE guidelines. If the OECD does not take them more seriously, who will?

There are other instruments in an evolving "toolbox" that the global union movement can use to counteract the social downside of globalisation. They include work by the Global Unions Federations to develop collective bargaining relationships with companies at an international level. Some 20 global framework agreements have been concluded – most in the past two years – between the federations and companies in sectors such as mining, chemicals, food, forestry, services and automobiles.

TUAC is also part of a joint Global Unions committee reviewing the social performance of enterprises in which workers' pension and saving funds are invested, and it is beginning to train union trustees.

We have also been working closely with the European Trade Union Confederation and the European Parliament to ensure that, at the European level, initiatives can be taken to achieve better enforcement of the MNE guidelines and linkages developed with European Works Councils.

There are also non-government activities in which unions are participating, such as the Global Reporting Initiative's (GRI) work to establish common international standards for corporate reporting on social and environmental sustainability (see article p.14), or certification schemes such as SA 8000.

The International Labour Organization itself is having to define its own role in the area of corporate social accountability – one task for the newly established ILO World Commission on the Social Dimension of Globalisation.

For labour perhaps the greatest danger is not globalisation itself; it is rather to argue policy paralysis as a result of it. Some of the tools to prevent this paralysis are there – it is up to the union movement to make sure it uses them effectively, but governments cannot absolve themselves from their own ultimate responsibility for managing markets globally. ■

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Japan: in search of a winning formula

Risaburo Nezu, Senior Executive Officer at Fujitsu Research Institute and board member of the Research Institute of Economy, Trade and Industry, a research organ of the Japanese Ministry of Economy, Trade and Industry*

Teamwork, goals, out-of-bounds: sport is often held up as a model for business. Now, the success of a French sports personality in Japan may hold lessons for the country's corporate players.

A few months after the FIFA soccer World Cup, the fever with which the Japanese people watched their players in blue heroically reach the latter stages of the competition has not much dissipated in Tokyo. But the interest is moving quietly from that of a sports event to the personality of a foreigner who engineered the team's unexpected success and how he did it. He is Philippe Troussier, a 47-year-old Frenchman who coached the Japanese team for four years until stepping down just after the World Cup. His place has been taken by another non-Japanese manager, the Brazilian Zico. Mr Troussier has set a high standard.

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No longer the odd couple

In fact, his is the second French success story to take Japan by storm after Carlos Ghosn, the CEO of Nissan, who was sent by Renault to rescue the financially troubled second largest automotive company in Japan and now enjoys widespread respect in Japanese circles (see references).

Mr Troussier was invited to Japan four years ago when the country, together with Korea, volunteered to host the World Cup 2002. Doing well in football became a matter of national pride for both co-hosts. Humiliating defeat at an early stage of the competition had to be avoided. This was an ambitious goal for Japan, since it had never won a single game in the history of the World Cup! By 9 July, when the Japanese football team made it through to the final stages, Mr Troussier had become a national hero. Eventual defeat by Turkey would not change that. The emperor and prime minister each sent a message to express their personal thanks.

Mr Troussier's rise is full of lessons for Japanese managers working in large companies. When the Frenchman was chosen, there was considerable doubt and suspicion as to whether a foreigner should be allowed to coach a Japanese team at all. Moreover, Mr Troussier was largely unknown in Japan – nor was he a household name in France – and despite some success in Africa, his track record had not been that outstanding. Hardly a first choice candidate for a nation bent on avoiding embarrassing defeat. To cap it all, this Parisian had to speak through an interpreter.

How irrelevant all of this proved to be. Mr Troussier's first pleasant discovery was that he would work with several good young players with international potential. But because of the heavy culture of seniority and other background issues, they had not been given the chance to demonstrate their talents. He promptly replaced old players with these young people, making Japan's perhaps the youngest team in the competition. (Ironically, his own country France's dismal failure at the World Cup has been put down by many to a failure to do just that: renew an ageing team.)

Mr Troussier urged his players to think for themselves and act independently, rather than waiting for his instructions. A spirit of independence and mental toughness were the qualities he wanted to inject into the minds of the Japanese players.

Out of frustration, the Frenchman occasionally criticised Japanese attitudes, sometimes in rather acerbic fashion. "Those who wait until the traffic signal turns green are of no use on the pitch. You must go when there is no car coming," he once said. In many respects, this ran counter to the culture that had dominated the Japanese sports community, where collective achievement is given priority over individual success. He introduced a sense of competition among the teammates and caused a public uproar when he did not include some popular names in the final team sheet. In short, his management style and handling of problems were anything but Japanese. He was stubborn and from time to time caused tensions in the camp to rise. His abrasive style nearly cost him his job early on, but success followed success, with a runners-up spot for his youth team at the FIFA World Youth Championship Nigeria 1999, a quarter-finals place at the 2000 Sydney Olympics and victory in the Asia Cup the same year. How right he was to stick to his guns; in Japan, a polite and conciliatory coach would probably not have achieved as much.

If only Japan's companies could follow Mr Troussier's example. In the 1980s, Japanese firms dominated key global industries such as electronics and automobiles. Today, although information technology is still a strength, the world corporate directory is dominated by American and European names, like Nokia, Motorola, Microsoft and Dell. Korean electronics companies, like Samsung, are competing head-on with Japanese ones. (Incidentally, Korea also enjoyed World Cup success under a foreign coach, Dutchman Guus Hiddink.) And three of the five main Japanese automotive companies are foreign-owned. Japanese industry has without doubt lost ground.

But as the case of Mr Troussier shows, a leader from abroad can have a better chance of succeeding in driving industry forward where local managers fail. Insiders tend to shy away from a bloody reform. They are either too close to the people or too used to established working practices. Japanese CEOs have long been chosen from the inside. Continuity is too often seen as important, the fear being that a major break with the past would only result in confusion and a loss of loyalty and morale.

Another lesson from the experience with Mr Troussier, who never played for France and who has a Master's degree in sports science, is that playing and coaching call for very different talents. Selecting managers based on in-company record is a fundamentally flawed approach. Yet, this is what most Japanese companies still do.

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Mr Troussier made clear what he wanted from his team. He asked the same of his players, urging them to come forward and speak clearly. This is in sharp contrast with Japanese management practice where silence and evasiveness rule.

An international perspective was another quality that Mr Troussier brought to the job. European players are used to playing abroad, including in Japan's J-league, with teams like Grampus and FC Tokyo. But apart from Ichiro, a Japanese baseball player plying his trade in the US, Japanese sports people rarely play abroad. Under the Frenchman, several stars joined leading European clubs. Though the Japanese Football Association feared losing their top strikers, Mr Troussier was uncompromising.

The CEOs of leading global companies like Canon and Sony spent their early years in foreign subsidiaries. Ironically, such overseas posts were not mainstream career paths. Yet they created the bosses that now lead these successful companies.

This is what openness is all about. As well as trade liberalisation, foreign investment and international capital transactions, openness should apply to recruitment of managers and skills. In general, the Japanese are very cautious about immigration. They fear it would result in more crime and higher unemployment among locals. However, the success of Mr Troussier is leading people to think that foreigners can do some good after all.

Is it just a coincidence that Mr Troussier and Mr Ghosn are both French? Japan and France knew very little about each other. In fact, they were often at odds with each other, as well as with everyone else. The French viewed the Japanese as economic obsessives. One French leader famously likened them to ants scurrying around and invading with their industries. In turn, the French were hardly seen as an open, corporate lot, but rather as arrogant, with their own suspicion of foreigners and seeming respect for hierarchy probably making them quite like the Japanese. And while the Japanese were fond of French wines and fashion, they had never viewed France as a model business nation. Now the two nations enjoy each other's company immensely. For while Messrs Ghosn and Troussier have been opening Japanese corporate minds, Paris has become home to Japan's first major overseas cultural institute.

A good number of the Japanese players who excited the Japanese people in June 2002 left for Europe this summer. They will form the core of the World Cup team in 2006. The number of students leaving Japan to study abroad is also on the rise. Foreign companies in Tokyo are pleased with their increasing popularity among top-notch students who 10 years ago would never have thought of applying to them for jobs. A gradual but steady change is occurring in the business community of Japan. The World Cup 2002 probably helped accelerate this change. At long last, the Japanese have begun to appreciate the real benefits of openness. ■

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Transparency for FDI*

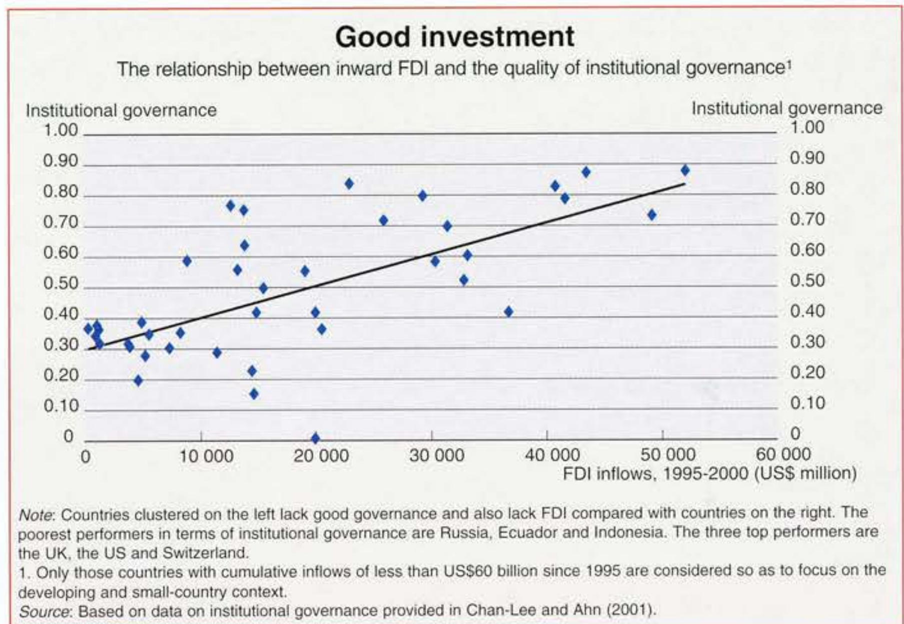
OECD Directorate for Financial, Fiscal and Enterprise Affairs

Investment is partly about taking risks, though not just any risk. In fact, transparent systems where the judicial framework is efficient and corruption is low tend to receive more investment.

By its nature, transparency cannot be easily quantified, nor can it be isolated from other policy aspects that impinge on foreign direct investment (FDI). Owing to the links between the regulatory structure of a country and the transparency of its policies, the focus needs to be both on the nature of the rules applying to foreign investment and on the extent of transparency in their implementation.

Studies indicate that business environments often remain non-transparent even after governments have moved to enact clearer policies, simply because those measures are not actually implemented. However, except in cases where the host government maintains an outright prohibition on market access by foreign firms, the implementation of relevant legislation is likely to be more important in shaping investors' perceptions than is the actual legislation itself. National treatment, for instance, may be enshrined in legislation in many countries, but if foreign firms are effectively discouraged through discretionary decisions of the relevant national authorities, they will perceive such arbitrariness as being just as restrictive as an outright prohibition on foreign investment.

This point is brought out clearly in a major study of 55 developed and developing countries, which found that "better functioning legal systems and governance and better enforcement appear to be more important than legal origins *per se* in terms of their impact on development" (S. Ahn and J. Chan-Lee, see references). This study, path-breaking in many respects, of the informational quality of financial systems and economic development, constructs indices for various aspects of transparency for 55 countries. Of particular relevance in the context of FDI is the measure of institutional governance (see graph).



Note: Countries clustered on the left lack good governance and also lack FDI compared with countries on the right. The poorest performers in terms of institutional governance are Russia, Ecuador and Indonesia. The three top performers are the UK, the US and Switzerland.

1. Only those countries with cumulative inflows of less than US$60 billion since 1995 are considered so as to focus on the developing and small-country context.

Source: Based on data on institutional governance provided in Chan-Lee and Ahn (2001).

Problems with transparency are almost certainly one of the main reasons why Russia, despite having a large domestic market, abundant raw materials, an educated workforce and geographical proximity to Europe, does not rank even in the world's top 30 destinations for FDI.

There are wide variations in inflows even for countries with the same institutional governance rating – as one would expect given the multiplicity of factors behind the investment decision – but overall the relationship between the quality of institutional governance and the level of inflows is clear and positive. Thus, countries where the rule of law prevails and is enforceable, the judicial system is efficient, corruption is low and ownership is less concentrated, receive more investment.

One of the most interesting national cases relates to China, whose policies toward foreign direct investment have been quoted in literature both as examples of the virtues of raising transparency, and to point to areas where problems remain (see box).

Russia arguably provides one of the clearest examples of a divergence between regulation and implementation. A recent OECD survey of the investment environment in Russia found that the otherwise adequate rules-based legal and regulatory environment was

consistently being undermined by failures in implementation and enforcement (see references).

There is no unified economic space, no "level playing field" for businesses in Russia, because of the multitude of administrative barriers and obstacles encountered by investors, particularly at regional level, often in contravention of federal legislation and regulation. As specific examples of unpredictable hurdles to be surmounted by investors at federal level could be mentioned sudden withdrawal of frequencies from telecommunication companies, or sudden unavailability of previously posted railway freight tariffs which served as a basis for feasibility calculations. At the regional level, examples abound in the form of unforeseen licensing or permission requirements, license fees in excess of what is legally required, tax payments that are negotiable rather than statutory, "voluntary" contributions to extra-budgetary funds, etc. In addition, the general burden of licensing and other policy-induced start-up difficulties at regional level is so onerous that firms specialising in helping new businesses to manage this process are becoming a new growth industry.

These manifest problems with transparency are almost certainly one of the main reasons why Russia, despite having a large domestic market, abundant raw materials, an educated workforce and geographical proximity to Europe, does not rank even in the world's top 30 destinations for FDI. Significantly, both foreign and domestic investment are low in Russia, suggesting that local investors are as discouraged by the lack of transparency as are foreign ones. ■

This is extracted from a new OECD book, Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs. *For more on this subject, e-mail daf.contact@oecd.org*

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China comes into view

China's business environment has become far more transparent since Deng Xiaoping began his programme of reforming and opening up the Chinese economy at the end of 1978, but the authorities' way of dealing with private enterprises is still largely characterised by relationship-based rather than rule-based decision-making.

Laws such as the Joint Venture Law were put in place hurriedly to accommodate new forms of business enterprise. At first these were sketchy, often amounting to no more than a few pages of general stipulations. Business legislation has since become increasingly complex and precise. Law courts, which had virtually ceased to function by the 1970s as a result of the total politicisation of law, began to develop in the 1980s as lawyers and judges were trained and appointed. However, the application of law in China remains under the control of communist party leaders at all levels and is better described as rule *by* law rather than the rule *of* law.

Regulations governing inward FDI exemplify this problem. Local authorities such as the Special Economic Zones in south China and the other open coastal areas have the power to approve the establishment of foreign-invested enterprises up to established maximal values, but the process of approval is not always wholly transparent. In the 1980s it was often necessary for a foreign company to spend several years building relationships with local officials before securing such approval, though this practice has (at least in the more developed regions) become less necessary in recent years. The line between central and local approval powers has also been more blurred in practice than the regulations suggest.

Secrecy has been replaced by openness, but although information is more widely available, it is not wholly reliable. Before reforms began, most of the country was closed to foreigners and economic statistics were largely classified top secret. The whole territory (with some exceptions) is now open to all, and the National Bureau of Statistics has been publishing heavy yearbooks replete with socio-economic statistics for two decades. Serious problems,

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however, beset major series such as annual GDP growth, unemployment and non-performing loan ratios.

China's entry into the World Trade Organization (WTO) in December 2001 has increased the pressure for transparency, initially regarding laws and regulations specifically related to commitments to the country's WTO partners, but eventually extending inevitably to all matters pertaining to business done by foreign entities in China. Leaders like the prime minister, Zhu Rongji, who are determined to use foreign competition as a weapon in reforming the inefficient state-owned enterprises, will strive to ensure such transparency.

Ranged against them are protectionist voices arguing in favour of developing "national champions", or merely defending the living standards of those employed in over-manned sectors. Local officials, pressed by central government to remit a larger share of their tax revenue to the centre, often support such protectionism (much of it regional as well as national), and prefer to maintain freedom of action in, for example, levying local charges.

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The global business

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Global models

Globalisation has made the world a smaller place and has changed the way of doing business in OECD countries. But did you know that a significant part of global integration reflects trade within transnational firms and industries?

With globalisation, not only are businesses exporting their goods worldwide, they are also producing them worldwide, often through complex production chains across several countries. Indeed, trade among different parts of global enterprises, such as components of a final product being manufactured by affiliates in several countries, has increased significantly since the late 1980s. Such global companies or industries can be found in a range of sectors, like designer fashion, automotive components, computers and mobile phones.

International trade within single firms accounts for around one-third of goods exports from both Japan and the United States, and a similar proportion of all US

goods imports and one-quarter of all Japanese goods imports. Few data are available for other countries, but given the increasing importance of foreign direct investment, it is likely that the importance of this **intra-firm trade** has increased at the global level.

The nature and extent of intra-firm trade seem to vary with the income level of the trading partners. Much intra-firm trade between high-income countries probably involves nearly finished goods destined for affiliate companies with little additional manufacturing taking place. About two-thirds of US intra-firm imports by multinationals with a foreign-based parent company go to an affiliate primarily involved in marketing and distribution, for instance. Even when the goods received are for further manufacturing, much of the production will be bound for local markets.

But intra-firm trade between rich countries accounts for a high share of bilateral trade for some middle-income economies, and here the primary role of the foreign affiliates is more likely to be manufacturing to produce goods destined for other markets, including the country of the parent company. For example, in 2000, two-thirds of US imports from Mexico were intra-firm due to extensive use of *maquiladora* – plants in Mexico under foreign control, located in the border region with the US and devoted to the assembly and re-export of goods.

Trade between different firms of the same industry is also a strong feature of OECD countries, involving the import and export of similar goods by the same country. It could be the export and import of different models of car, for example, or the import of cheap textiles and the export of more expensive ones. The extent of **intra-industry trade** is typically much higher for manufactured goods than non-manufactured goods, and is highest for the more sophisticated manufactured products such as chemicals, machinery and transport equipment, electrical equipment and electronics. This is because sophisticated manufacturing is more likely to benefit from economies of scale in production and are easier to "differentiate" to the final consumer. More complex manufactured products which rely on many components and/or processes may also benefit more readily from splitting up production across countries.

Manufacturing intra-industry trade has risen in most OECD countries since the 1980s. In some countries, it continues to rise from already high levels. For instance, in Mexico it rose from 63% of total manufacturing trade in 1988-91 to over 73% in 1996-2000. In the US, it rose from 64% to 69% in the same period. In several countries, like Austria, France and the UK, manufacturing intra-industry trade has been in the 70-75% range for over a decade. In Korea and Japan, it is lower, at around half of total manufacturing trade, and in a few countries, like Australia and Iceland, manufacturing intra-industry trade accounts for about a third of total manufacturing trade.

Manufacturing intra-industry trade has risen in most OECD countries since the 1980s. In some countries, it has been in the 70-75% range of total manufacturing trade for over a decade.

There are currently eight OECD economies – Austria, Belgium, Czech Republic, Hungary, Ireland, Luxembourg, Netherlands and Slovakia – where both imports and exports account for more than half of GDP. These countries all tend to have relatively high intra-industry trade. Economist Paul Krugman argues that the emergence of such "supertrading" economies is essentially the result of the "slicing up of the value-added chain" internationally. The number of these supertrading economies doubled over the 1990s; Mr Krugman reckoned that in 1990 there were six, but by 2000, there were at least 12.

This internationalisation of production may mean that the initial consequences of any shock to demand are more dispersed across countries. At the same time, global trade may follow trends in the world economy more closely than in the past. The recent global slowdown has been accompanied by a severe downturn in world trade growth unprecedented since the first and second oil shocks, although the slowing in global GDP growth has so far been relatively modest.

Intra-industry and intra-firm trade may have accelerated the international transmission of certain industry- or product-specific signals, including shocks. The speed of the collapse in trade in high-tech products is an obvious recent example of this, as reflected in a sharp fall in bilateral trade between the US and certain Asian countries. For countries and regions, the effects of such shocks may be asymmetric, with some feeling the pinch more than others, but the industry worldwide takes the impact.

As so much international trade takes place within firms and industries, trade levels may become less responsive to short-term changes in international price competitiveness than before. After all, if an increasing proportion of trade is in intermediate goods as part of an international production chain, then a devaluation, for instance, is unlikely to have much influence on competitiveness. But persistent exchange-rate realignments or shifts in unit labour costs between countries may lead firms to relocate entire plants to more predictable, if not more cost-competitive, countries. And if a multinational enterprise has to retrench in one market, it may cause cutbacks in other countries. All of which suggests that if globalisation has led to new ways of doing business, then policymakers have to think globally too. ■

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Ukraine: A miracle in waiting?

Mehmet Ögütçü and Jaroslav Kinach*

Ukraine is a large country of some 50 million people that shares a border with OECD member, Poland. It was also the Soviet Union's second largest republic after Russia. Like Russia, it has been rather slow since the Union's dissolution in undertaking decisive economic reforms. The economy is improving, though there is much to be done before Ukraine can fulfil its undoubted economic potential.

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Sky's the limit: Monastery of Caves, Kyiv

When Ukraine's parliament, the *Verkhovna Rada*, declared independence in July 1991, and confirmed it by a 90% majority in a referendum in December 1991, there was a widespread belief that as one of Europe's most ancient civilisations, Ukraine would quickly overcome the legacy of the Soviet Union, rebuild its economy, adopt western democratic values, and establish institutions that would support an open market economy.

There was also some fear that Ukraine's transition would be accompanied by unrest. However, the process has been unexpectedly smooth politically, with none of the conflict, invasion or insurgence that have so characterised Ukraine's turbulent history, or that of some of its neighbours. Democracy has been abused from time to time, but it is entrenched in law, and progress is being made in exercising and developing it. Three parliamentary elections have been held, most recently in March 2002. And a new constitution was adopted in June 1996 as a blueprint for developing a democratic and civil society.

All positive steps, yet there is some way to go before democracy and law become properly embedded and deep-seated corruption is stamped out. This would be helped by a stronger economy, and it is here that the going has been tougher than many expected. If Ukraine is to chase away the shadows of its history and secure its future, it really must get this dimension right too.

Partly to blame is nearly a century of suffocation under Soviet rule. Hangovers from that system, from cronyism to heavy bureaucracy, not to mention plain incompetence, have yet to be cured. But Ukraine's ills cannot be entirely blamed on past legacy and it too must shoulder some of the blame, as well as responsibility for change.

At last, there are encouraging signs. Ukraine's economic trends turned around in 2000 and record GDP growth of 9.1% was achieved in 2001 after a decade of decline. Inflation has also been curtailed and the national currency, the hryvnia (UAH), stabilised. These improvements have to be made sustainable.

Several factors triggered the recent impressive rate of growth. Obvious ones include devaluation of the hryvnia after the Russian financial crisis in 1998. This provided a major boost to exports of goods like metals and chemicals, taking advantage of a period of strong growth in world trade. A shift of small firms from the shadow to the formal economy led to growth in the private sector, which now accounts for about 65% of GDP.

However impressive this turnaround, the short to medium-term outlook is for some slowing in line with that of the global economy. A recent wave of import restriction measures by Russia, the EU and the US (on steel particularly) will not help exports, which account for roughly 60% of Ukraine's GDP growth. Russia is Ukraine's largest single trading partner, accounting for 22% of exports and 34% of imports, and because the ruble is sensitive to fluctuations in oil prices, Russia's exchange rate policy will also directly impact on Ukraine's economy.

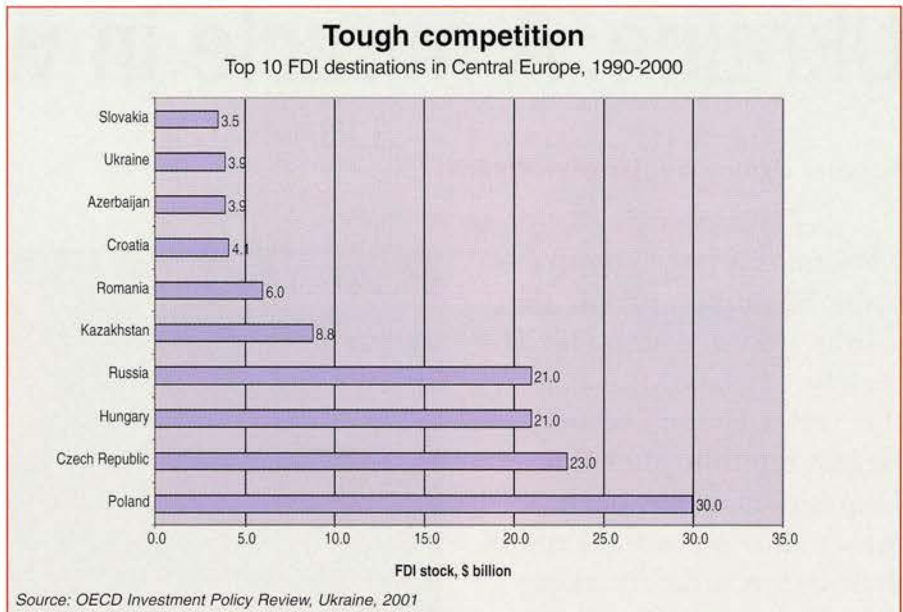
If Ukraine had a more robust economic foundation it might be able to deal with these problems. But substantial restructuring will have to be carried out if Ukraine is to achieve sustainable growth. At just US$720 per capita annual income is very low compared with US$1,750 in Russia and US$4,240 in OECD member Poland (World Bank estimates at purchasing power parties, 2001 exchange rate). Growth from this low base is surely feasible. With the right economic policies and provided political stability continues, the next 10 years could prove to be the decade of Ukraine's economic resurgence.

Slow and uncertain transition

It would be foolhardy indeed to expect the legacy of over 70 years of distorted central economic planning, and all the institutional and cultural legacy that goes with it, to be removed overnight. Ukraine's economy was deeply integrated with that of the Soviet Union and its extensive military industrial complex.

Dealing with the complexities of a free market economy, and making sure institutions operate openly and efficiently, remain daunting challenges even today for some OECD countries. But the problems are deeper in transition countries, where institutions and government apparatus may be inadequate, especially experience in policy formulation and execution. Nor could Western institutions provide a magic formula, particularly as they too had to acquire experience of transition.

Change is inconvenient, even when for the better, and so pockets of resistance were always going to make Ukraine's transition difficult, particularly from those that benefited from the previous regime or profited from



Source: OECD Investment Policy Review, Ukraine, 2001

disorder and cronyism. Even where intentions have been honest, the instincts of functionaries and other policymakers were more disposed to control economic activity than to create mechanisms to support private sector development and initiative.

Thankfully, changes are now happening. Macroeconomic stability has been restored and reforms have begun to make operations in the electricity sector more transparent; barter and inter-enterprise arrears have been reduced substantially; wage and pension arrears have been mostly eliminated;

One ingredient Ukraine needs plenty of is foreign direct investment to boost capital, improve skills and raise its economic performance generally. This goes for almost every sector of the economy.

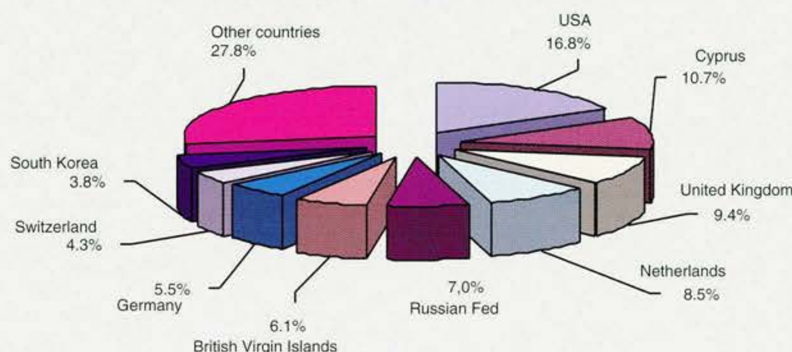
corporate tax privileges have been reduced, and so on. All these have been major steps in transforming structure as well as minds, and probably contributed to the recent acceleration in economic growth. The new and challenging Land Code, which came into effect on 1 January 2002, has also been a catalyst, as it introduces a formal mechanism for private land ownership. And from 1 January 2005, it will allow agricultural land to be traded and used as collateral.

Further deep changes in the economy are inevitable. Restructuring is needed in heavy and light manufacturing industries to draw in new technologies, streamline existing capacity and generally improve cost, quality and competitiveness. Continued privatisation of large-scale enterprises is crucial, including in the energy sector, together with continued reforms of the agricultural sector, and strengthening of the weak and undeveloped financial services sector.

However, institutional and regulatory reforms are also needed, partly to squeeze out corruption and red tape, and to establish fair and transparent rules of the game. In addition, comprehensive bankruptcy, corporate governance, and securities laws must be implemented.

FDI

One ingredient Ukraine needs plenty of is foreign direct investment (FDI) to boost capital, improve skills and raise its economic performance generally – just as in other successful transition countries. This goes for almost every sector of the economy, from agriculture to banking. FDI flows directly influence the balance of payments and constitute a major source of foreign currency, especially useful for servicing external debt.



Source: OECD

Unfortunately, Ukraine's record of attracting FDI has been very poor. From independence to the end of 2001, the stock of FDI reached only $4.4 billion or $88 per capita, less than 10% of per capita FDI in neighbouring countries like Hungary or Poland (see graph).

The need for investment capital is particularly acute since net outflow of capital from the economy has been estimated at $20 billion since independence, although some of it has slowly begun to come back.

Russia's influence is enormous in the context of FDI. Russian (and Ukrainian) businesses use offshore companies in Cyprus, British Virgin Islands, Switzerland and other countries to repatriate and invest their capital back home. Russian companies now control Ukraine's aluminum and oil refining sectors, while their presence is increasing in the processed foods, metallurgical and machinery sectors, banking and transportation.

Kyiv and its surroundings received a little over 40% of cumulative FDI, with Donetsk, Dnipropetrovsk, Odessa, Poltava and Zaporizhya accounting for another third. Crimea has attracted only 4% since independence.

Without reforms, Ukraine's prospects for FDI will not improve. Some of the key obstacles which confront investors were identified by the OECD in its recent publication *Ukraine: Progress in Investment Reform 2002*.

Poor and uncertain administration is a major disincentive. Foreign investors, even those used to poor service elsewhere, frequently complain that no one appears to be in charge to take decisions, resolve disputes or grant approvals. Investors shuffle from ministry to ministry in a seemingly endless bureaucratic maze, while facing the prospect of dealing with an onerous tax regime, and poor accounting standards and practices.

Governance is not up to scratch either. The lack of transparency in privatisation, not to mention asset stripping and insider dealing, are major disincentives for all investors. Corruption is also a real problem; according to Transparency International 2001 "Corruption Index", Ukraine ranks in 83rd position, ahead of only eight countries.

Rule of law is also a problem. Reform of the judiciary is under way to improve efficiency and transparency, and especially enforcement of judgements (particularly necessary to enforce contractual obligations).

Complex **tax laws and regulations**, combined with capricious administration, also top the list of investment disincentives. Unexpected changes to existing tax legislation have also damaged the government's credibility; for instance, in December 2001 parliament passed a new law abolishing tax privileges for enterprises with foreign investments in a bid to establish equal treatment between domestic and foreign firms.

Another area in need of action is the **banking system**. Despite a large number of banks (over 150 registered), the top 10 represent over 70% of all banking activities, worth

Ukraine: Key economic and social indicators

Capital:	Kyiv
Population:	49 million
Area:	604 thousand sq km
Currency:	Hryvnia (UAH)
Adult literacy:	98%
Urban pop.:	68%
No. of households:	8 million
Avg. no./ household:	6.1

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Key Economic Indicators:	2000	2001
Nominal GDP (current US$ bn)	31.3	37.6
Real GDP growth %	5.8	9.1
Inflation (CPI) %	25.8	6.1
Current account (US$ bn)	1.5	1.3
FDI (Net) (US$bn)	0.6	0.8
Gross international reserves (US$bn)	1.5	3.1
Fiscal balance, cash basis % GDP	-1.3	-1.6
Total public debt %GDP	45.3	37.9
Exchange rate US$ avg	5.4	5.4
Credit ratings: EIU: D		
Other:	industry/GDP	40.6%
	agriculture/GDP	14.7%
	investment/ GDP	20.4%

Sources: Derzhkomstat, Ministries of Finance and Economy, Institute for Economic Research and Policy Consulting; World Bank/IMF; EIU.

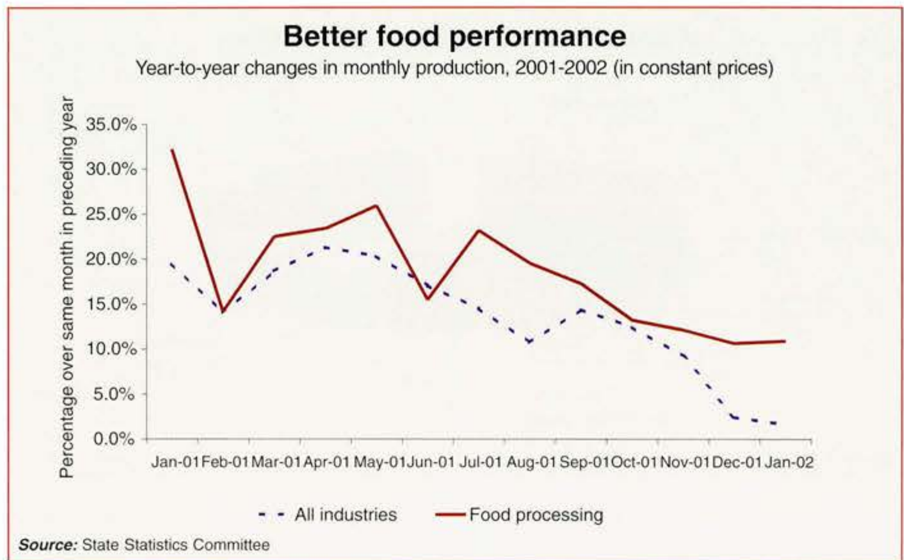
some UAH58 billion in mid-2002. The total capital of the banking system at UAH8.7 billion is very low, as are household deposits, despite double digit growth which has taken them to UAH15.2 billion at mid year 2002. While major regulatory and legislative improvements have been made, and improved bank supervisory and monitoring standards are being developed and implemented, the banking system still has not won over the full confidence of the public at large.

Privatisation trouble

The 2000-2002 privatisation programme clearly illustrates Ukraine's problems. The programme aims to sell off most of the 200 large enterprises holding over 80% of assets in the industrial and utilities sectors by attracting long-term strategic investors and foreign investors in particular. Naturally, the government sees privatisation as a way of bringing in not just capital, but new management and know-how, as well as being a major source of revenue. In 2001, revenues from privatisation constituted 11.3% of the total consolidated planned revenues to government and FDI generated some 60-70% of total privatisation receipts.

A major problem is how to manage the powerful, sometimes corrupt, economic power groups that privatisation has bolstered or created with control over metals, chemicals, gas, etc. Tax exemptions and the discretionary application of regulatory requirements clearly cannot continue, especially if the government is to improve the country's fiscal position. Receipts from recent sales of large companies have been disappointingly low, generating only UAH3 billion (about US$566 million) in 2001, which is half of what was planned. Prospects of meeting the 2002 target of UAH5.5 billion are remote since privatisation of the remaining nine *oblenergos* (regional electricity distribution companies) and the energy generating companies is still under review, while privatisation of the national telephone company, Ukrtelecom, has been postponed because of poor market conditions.

The Ukrainian government recognises the shortcomings in the investment climate. Its "Programme on Development of Investment Activity in Ukraine in 2002-2010" which introduces a complex set of measures aimed at further improvement in the investment climate, including further deregulation and liberalisation of business activities; creation of a stable and predictable legal environment; better banking and improved bankruptcy procedures.



Source: State Statistics Committee

The programme is in line with the **OECD investment policy recommendations** for Ukraine, and it is clear that more work is needed to advance private sector development, for instance, and put privatisation on to a predictable and stable, case-by-case, footing. The benefits and costs of investment incentives have to be better assessed and distorting tax privileges stamped out. International arbitration of disputes is needed, as are courts of appeal for economic disputes. And Ukraine's accounting and auditing practices have to be aligned with international standards, in particular for publicly-traded companies. Other initiatives like a "one-stop-shop" agency to facilitate foreign investor licences, approvals and so on, would also be valuable.

A major problem is how to manage the powerful, sometimes corrupt, economic power groups that privatisation has bolstered or created with control over metals, chemicals, gas, etc.

With a list like this, it may appear as an exaggeration to call Ukraine a "miracle in waiting". But it is a large and untapped market. It has a highly educated, yet inexpensive, labour pool; over 1,300 scientific and technical institutes specialising in artificial intelligence, metallurgy and aerospace, to name just a few areas. The country is endowed with vast mineral deposits, including 27% of the Earth's most arable and fertile top soil (chernozem). And, its location straddling central Europe, the Black Sea and Russia provides an important crossroads for the region and also a gateway to Asia. These are all attributes the country will no doubt be putting on the table in present entry talks to the WTO and in a future bid for EU membership.

Ukraine might not quite be a miracle economy now, but by taking advantage of favourable growth and following a course of aggressive reforms, it has the potential to become one in the future. ■

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Banking on the euro

Carl Gjersem, OECD Economics Department

The introduction of the cash euro on 1 January 2002 has changed the lives of more than 300 million people. The second *OECD Economic Survey* of the euro area looks at budgetary policies and pressures in member countries, the prospects for economic recovery in the currency zone and the performance of the European Central Bank. But it also takes a special look at whether, with a single currency available across 12 countries, switching your bank account or mortgage to another euro area country is now an option or still a daunting task.

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Travellers in the euro area complained bitterly early this year when they found that the long-awaited dream of unfettered cross-border shopping had remained costly. True, the euros they drew out of bank cash machines abroad were the same as the euros at home, making it easy to compare prices. But when the travellers received their bank statements they found they were being charged far more than back home for the privilege of using their cash cards. That practice was ended before the holiday season by an EU directive, but integration in the banking sector still has a

long way to go to catch up with the integration that is taking place in other financial markets.

As the *OECD Economic Survey* of the euro area found, even the massive merger and acquisition activity in recent years might not advance matters as much as some might expect, since this has served mainly to concentrate national banking markets. In fact, there have been relatively few cross-border tie-ups. It is also virtually impossible to make comparisons about mortgages since lending systems for house purchases are very different from one country to another, while barriers to foreign entrants into local insurance and pension markets also remain considerable.

For consumers, transferring money from one euro area country to another is still generally much more expensive than transferring money within a country. The banks have argued that this is because there is no integrated pan-European retail payment system, so that transactions have to be processed manually and are therefore more costly. But they also say that the volume of such transactions is too small to make an integrated system worthwhile. From next year, EU authorities have ordered banks to charge the same for card use anywhere in the euro area from July 2002. But only time will show whether the lower costs will raise the volume of such transactions enough to make a cross-border system profitable, the *Survey* says.

When it comes to day-to-day experience, euro zone banking still very much begins – and ends – at home. Banks do not seem to reach out for prospective customers beyond national borders, while consumers do not go cross-border shopping around for credit either.

EU authorities have been inclined to let market forces do the work. As the survey notes, the fact that no common system has been developed to facilitate cross-border transfers of small sums even after decades suggests it is time for the authorities to adopt a more pro-active role. ■

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Composite Leading Indicators: helping forecasters forecast

How reliable can economic forecasting be? It depends on several factors, like the quality of data and models, skill and judgement, etc. A key problem is anticipating turn-arounds, those sometimes elusive points when rising growth begins to slow or a downturn becomes an upswing.

The OECD Composite Leading Indicators (CLIs) are designed to provide early signals of turning points (peaks and troughs) between expansions and slowdowns of economic activity. CLIs are calculated by combining component series that cover a wide range of key short-term economic indicators. These include observations or opinions about economic activity, housing permits granted, financial and monetary data, labour market statistics, information on production, stocks and orders, foreign trade, etc.

The component series selected are those known to provide an indication of future economic activity: building permits, for instance, are an indication of possible future construction, whereas unemployment, by contrast, is a lagging indicator in that it reflects decisions prompted by past economic activity. The number of component series used for the compilation of the OECD CLIs varies for each OECD country, but ranges between 5 and 11 series.

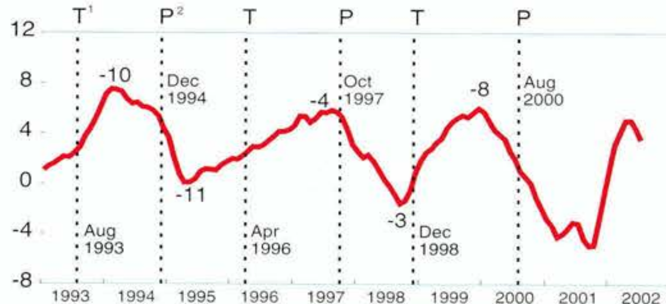
The OECD uses a six-month rate of change for CLIs as its preferred pointer to possible turning points as this is less volatile and provides earlier, clearer signals for future turning points. As the graph shows, the CLI provides early signals for the turning points in total OECD economic activity. For example, a peak in the six-month rate of change (annual rate) of the CLI for the total OECD occurred 10 months before (*i.e.* –10) the actual peak in economic activity in December 1994. The CLI turned downwards in June-July 2002; however, two months of evidence is not sufficient to be able to use this drop as a forewarning of a downturn in economic activity.

CLIs provide an important aid for short-term forecasts (6 to 12 months) of changes in direction of the economy, and so help economists, businesses and policymakers to improve their analysis of current trends and anticipate economic developments. However, CLIs are one instrument of analysis and are no substitute for quantitative or long-term forecasts based on econometric models. They are designed to provide qualitative information so that judgements can be made about short-term economic movements, rather than providing quantitative measures.

The OECD CLIs are calculated for 22 member countries and seven aggregate geographical zones (total OECD area, G-7, NAFTA, OECD-Europe, European Union, Euro area and the Big Four European economies). The data are published monthly in *Main Economic Indicators*. The latest CLI updates as well as further information on the compilation of OECD CLIs are available at http://www.oecd.org/std/cli and by e-mailing stat.contact@oecd.org

Composite Leading Indicator

Total OECD, six-month rate of change (annual rate)



1. Trough (T) observed in the economic cycles
2. Peak (P) observed in the economic cycles

Source: OECD Main Economic Indicators

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The Banker

Retiring later makes sense

Willi Leibfritz, OECD Economics Department

Ageing poses a serious challenge to OECD countries, in particular, how to pay for future public pension liabilities. And early retirement places an unsustainable burden on pension financing. There is no easy solution, but delaying retirement could help.

Retiring early has become so ingrained in OECD countries that these days it is almost an individual professional goal. It is even possible to drum up economic arguments in its favour: retirees spend money rather than save it, for instance, and are valuable for such sectors as tourism. Retiring early, some argue, frees up jobs for younger recruits and helps to boost productivity. To many, retirement is a hard-earned right, and so the earlier the better. Indeed, futurists have been telling us for years that early retirement would become the norm, that thanks to labour-saving technology we would soon be spending more of our lives at play and less at work.

The average age of actual retirement is often three to five years earlier than the standard official age. In Europe, less than half of the male population aged 55 to 64 is currently working. Life expectancy at the average effective retirement age can be as high as 18-20 years, about a third longer than it was 30 years ago.

All very well, but the reality is quite different. Early retirement may seem like a worthy individual goal, but it is a socially expensive one, and, as far as public pensions are concerned, quite unsustainable. The essential reason is that more people are retiring early and living longer. That means more retirees depending on the funding of those in work for their income. The outlook is worrying. In the next 50 years, low fertility rates and rising life expectancy in OECD countries will cause this old-age dependency rate to roughly double in size. Public pension payments, which pay 30-80% of total retirement incomes in OECD countries, are expected to rise, on average, by over three percentage points in GDP and by as much as eight percentage points in some countries. Such is the pressure on pension funds that there is a danger of today's workers not getting the pensions they expected or felt they paid for.

Action is needed, but simply aiming to reduce the generosity (and cost) of public pensions, or trying to augment the role of privately funded pensions within the system, though necessary steps, may be insufficient to deal with the dependency challenge. After years of advancing early retirement schemes to avoid redundancies and higher unemployment, many governments are now looking at persuading people to stay in work until they are older. Surely, the thinking goes, if we are healthier now and jobs are physically less strenuous and unemployment is down, then perhaps the present rate should rise anew. In fact, increasing the participation rate of persons aged 55 to 64 years is one of the main objectives of social policy within the European Union under the Lisbon and Amsterdam Treaties.

The approach makes economic sense. For a start, as long as the extra labour resources from delayed retirement are put to work, then in theory the level of GDP will rise, thereby increasing the resources available for consumption. This is simplistic of course: having more old people at work is not

enough to improve productivity. Indeed, some contend that the level of GDP could fall, since retiring early acts as an incentive to work hard and save more and so boosts productivity, whereas delaying it could dampen the morale and productivity of would-be retirees. However, these negative effects appear to be small, so on the whole retiring later would increase GDP in the longer term. Working people certainly pay more income taxes and social security contributions than retired people, so a later effective retirement age would generate more funds to pay for pensions. Likewise, there would be less pressure on those funds as delayed retirement means people start drawing their pensions later. Working longer also helps people to stay out of poverty, which is particularly important where pensions risk falling to low levels.

Still, people have been retiring at younger and younger ages for decades. They have been enticed by generously high net pensions and other benefits, as well as the lure of more travel and leisure; but they have also been pushed by employers anxious to cut costs (it is often easier to shed older staff, particularly in hard times) or boost productivity by replacing them with younger recruits. Apart from the cost savings of later retirement, there is an equity issue at play here: while early retirement is an option for many workers, labour markets tend to prevent late retirement. Healthy people may wish to work longer, rather than leave work or accept low pensions. Not everyone wishes to be "retired" early. Equally, companies may wish to retain older employees for their experience, but cannot, often due to inflexible labour market rules that, in the end, hurt workers. Also, labour taxes may be too high for employers, or part-time jobs inaccessible to older workers. If retirement is delayed, these market conditions would have to be improved. Otherwise, as some economists argue, later retirement could simply fuel older unemployment.

But this does not alter the key message: early retirement places an unsustainable burden on pension financing. Governments must reconsider their policies with respect to retirement age. Comparing effective retirement ages and labour participation of older workers across countries may be instructive.

Different old folks

The standard official retirement age to qualify for a public pension in most OECD countries is currently 65. The chief exceptions to this are France and Korea, where it is 60, and Norway, where it is 67. Several countries offer early retirement pensions allowing people to retire two to five years before the standard age. And in a number of countries, there are relatively generous eligibility criteria for disability pensions and unemployment benefits for older workers. Severance packages, including early occupational pensions, also help some older workers to make the jump at relatively low personal cost.

It is therefore not surprising that the average age of actual retirement is often three to five years earlier than the standard official age. Only in the United States does the average actual retirement age correspond to the current standard age (65). Even so, the United States is gradually raising the retirement age to 67, and is debating the merits of later retirement. The average worker in Japan and Korea retires at 69 and 67, respectively four and seven years later than the official standard age. But these are the exceptions. In Europe, less than half of the male population aged 55 to 64 is currently working (see table).

Life expectancy at the average effective retirement age can be as high as 18-20 years, about a third longer than it was 30 years ago (see graph, page 38). It is projected to increase further, so the retirement period will lengthen unless retirement itself is delayed.

Delaying retirement looks like the only option. Increases in the standard retirement age of women to match that of men are being phased in in Australia and Germany, and for both men and women in Hungary, Italy, Japan, Korea and the United States. Pension systems are also being adjusted so that if people retire earlier their pension level will be reduced accordingly. This seems fair – experts refer to it as being actuarially neutral – since it reduces pressure on pension funds by ensuring that benefits are more in line with contribution payments. Australia, Finland, Germany, Iceland, Italy, Netherlands, Norway, Sweden and the United States are all moving in this direction.

Other ways of discouraging early retirement include reducing pension levels directly, as Germany is doing, or prolonging the contribution period needed to qualify for a full pension, the approach France and Hungary are adopting. Some countries are tightening access to disability pensions and

Men at work

	"Normal" official retirement age[a]	Average effective retirement age[b]	Employment rate of older men[c]	
			1980	2000
Australia	65	62.3	67	59
Canada	65	62.2	71	58
Finland	65	59.8	55	44
France	60	59.3	65	38
Germany	65	60.5[d]	64	48
Italy	(new) 57 to 65	59.3	39	30
Japan	65	69.1	82	78
Korea	60	67.1	–	68
Netherlands	65	61.6	61	50
Norway	67	64.2	79	73
Spain	65	61.1	71	55
Sweden	65	63.3	77	68
United Kingdom	65	62.0	–	60
United States	65 (new 67)	65.1	70	66

Notes
a. Public pension scheme
b. 1994 to 1999
c. Employment of male workers at age 55 to 64 as a percent of male populations of the same age
d. Western Germany, 1993 to 1998

Source: OECD

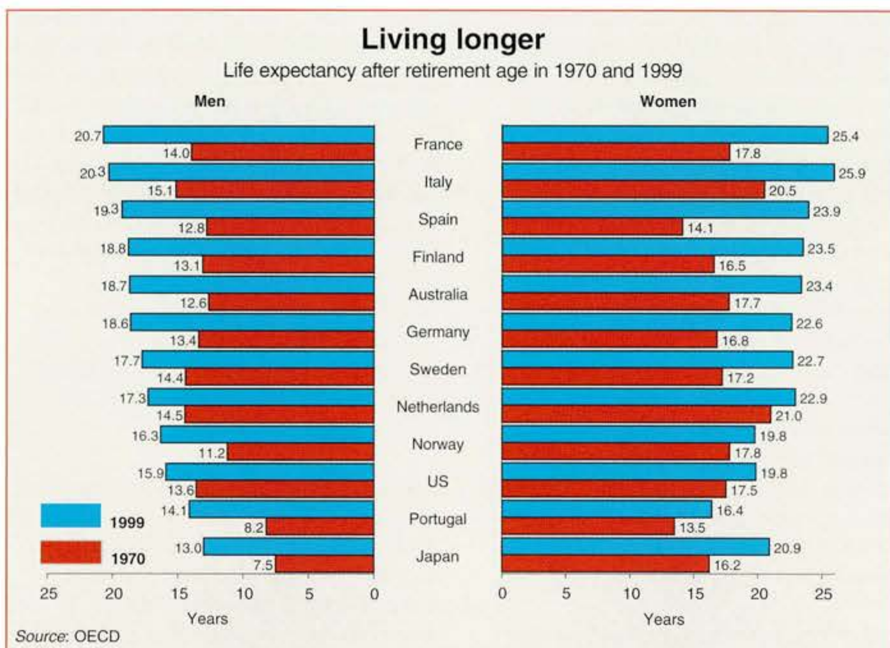
unemployment benefits (Finland, Germany, Netherlands, United Kingdom).

The risk of early retirement policies leading to unemployment has to be minimised and countries are also acting to improve employment opportunities for older workers by outlawing age discrimination (Australia, Netherlands, United Kingdom), or providing wage subsidies for older workers (France, Germany, Korea). But while these measures go in the right direction, significant incentives for early retirement still remain.

Reducing incentives for early retirement

Raising the effective retirement age cannot, of course, be achieved unless early retirement incentives are reduced. The OECD has calculated two measures of early retirement incentives in public pension schemes. The first is the replacement rate – a person's pension as a percentage of his or her working income prior to retirement; the higher the replacement rate, the higher the incentive to retire. The second measure is the change in net pension wealth from working an additional year; the principle here is that the incentive to retire early would rise if working an extra year implied paying additional contributions with little or no increase in future pension gains. Using this measure for 15 countries, it is evident that there are incentives to retire early in the regular old-age pension system, though not before the age of 60. In fact, early retirement is generally not permitted before this age. The only exceptions are Italy (where the earliest retirement age is 57 and the replacement rate of pension income is above 50% of previous earnings) and Australia (where individuals can draw on their mandatory savings from 55).

Not everyone wishes to be "retired" early, and companies may wish to retain older employees for their experience, but cannot, often due to inflexible labour market rules that, in the end, hurt workers. Also, labour taxes may be too high for employers, or part-time jobs inaccessible to older workers. These market conditions have to be improved.



But beyond regular pension systems, incentives do exist. In a number of countries, like Germany, Netherlands, Finland, Norway and France, disability pensions and unemployment benefits can be used as *de facto* early retirement benefits. There are also incentives for "normal" workers to retire after 60 but before 65 when pensions are offered with relatively high replacement rates. Sometimes, as in the UK and Canada, complementary occupational pension schemes also provide strong incentives for early retirement – the retirement age in some UK companies that have their own private pension schemes, is 60, and not the UK standard of 65.

Clearly, any attempt to push up retirement ages must be bolstered by policies aiming to increase both the supply and demand of older workers. Eliminating incentives for early retirement would help to solve the supply problem, as fewer workers will retire early. But it is obviously not enough that labour supply increases; demand should also be there. In practice, this should not be a major concern, since countries with high participation rates also tend to have high employment rates. Nonetheless, policy measures could help demand to meet supply. Making labour markets more flexible by allowing wages to better match labour productivity would increase demand for older workers. Strict employment protection also reduces the chances of older workers to find work. Also, retraining older workers would help supply and demand, and it would also be more cost-effective if workers were kept employed for more years.

Ageing will reduce the relative labour supply significantly over the coming decades, and governments should not reduce it further by providing incentives for early withdrawal from the labour market and penalising those who continue to work. Eliminating such distortions would encourage people to work longer and retire later so that effective retirement ages automatically adjust with rising life expectancy. People have a right to retire decently and confidently. Right now, the pressure on pension funds is such that, without action, this right is being eroded. ■

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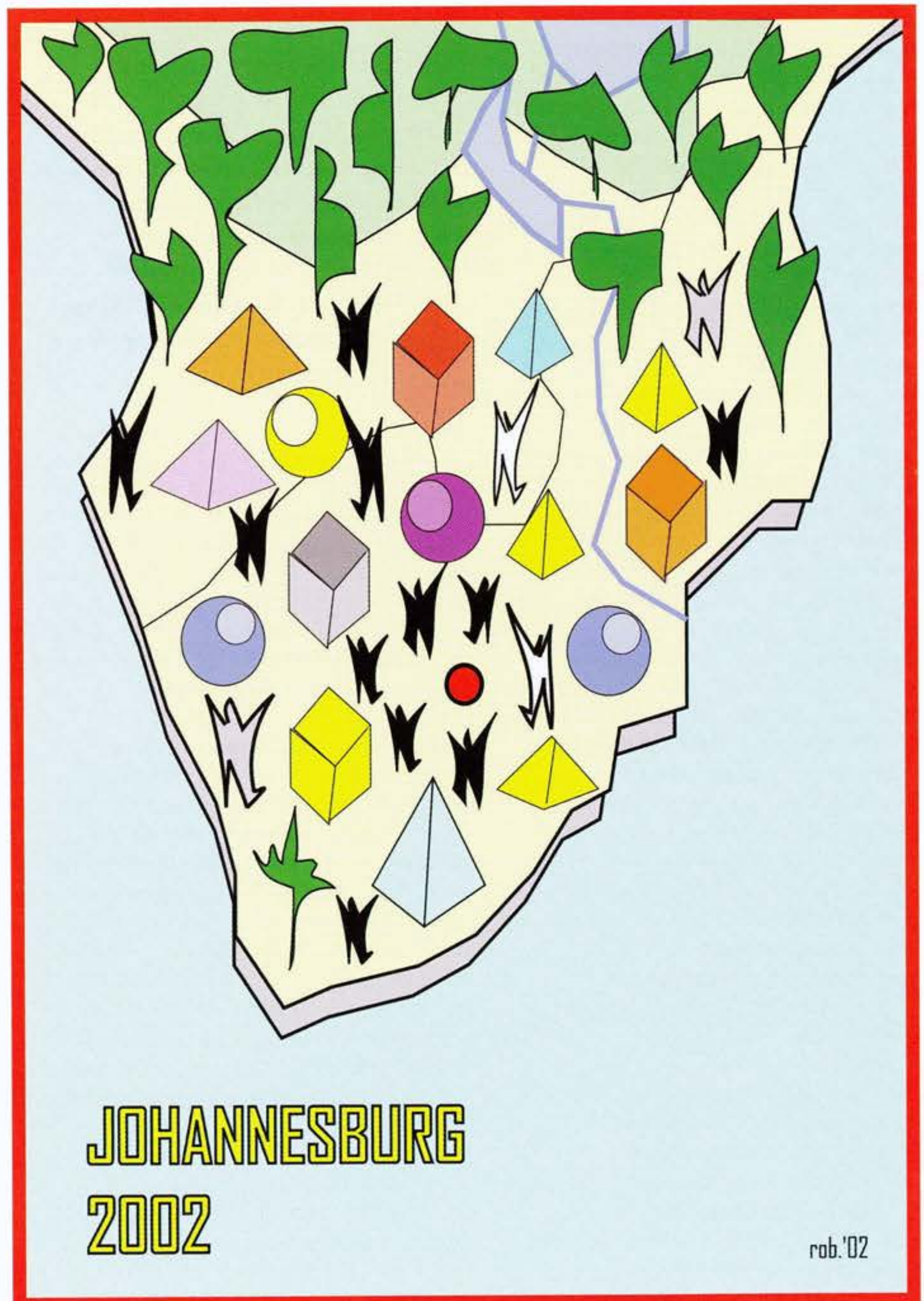
Johannesburg summit
Success or failure?

Ken Ruffing, Head, OECD Environment Directorate

The recent world summit on sustainable development was either a success or a disappointment, depending on whom you ask. For a clear assessment of the summit's achievements, it should be measured against what is in fact needed to achieve sustainable development and what was feasible in the current political climate.



No one really needed a global conference to discover that 10 years after the Rio Earth Summit there is still far too much poverty and disease in the world and that some environmental problems, such as greenhouse gas emissions, biodiversity loss and overfishing, have actually got worse since 1992. But because sustainable development embraces a complex array of economic, social and environmental issues, different countries and civil society organisations came to Johannesburg in August 2002 with very different – and sometimes incompatible – agendas. The result was a dauntingly long wish list of priorities, from reducing poverty and alleviating AIDS to reducing trade barriers or addressing global environmental issues. Opponents of business-led globalisation wanted an international legally binding

instrument to regulate multinational enterprises, while business leaders wanted acknowledgement of their role as constructive social partners. The carefully negotiated compromises that emerged from this left many participants dissatisfied.

But was the summit meant to satisfy all these different agendas? The UN General Assembly's mandate for this meeting was to take stock of what the agreements made in Rio have accomplished and identify further measures to implement them. The mandate also called for identifying areas where more effort and action were needed, as well as new challenges and opportunities. The Johannesburg summit was intended to win an understanding of the need for balance among economic, social and environmental concerns and to reinvigorate the global commitment to sustainable development. By this definition, the negotiators at Johannesburg fulfilled their mandate.

They restated key commitments and targets, such as halving by the year 2015 the proportion of people living on less than US$1 a day, added a few new ones, such as halving by the year 2015 the population without access to adequate sanitation (currently estimated at 2.4 billion), and hastened the expected pace of others, such as encouraging a more rapid shift to sustainable production and consumption. And they developed a clear and relatively comprehensive Plan of Implementation, describing how the already existing commitments and targets might be met. Moreover, the range of supportive actions (so-called Type II Partnerships) identified by groups of countries, the business community and other civil society actors – in many cases backed up by substantial financial commitments – augurs well for maintaining momentum and moving beyond the actions agreed through the inter-governmental process.

The four-page political declaration adopted at the end of the summit recognised the links between poverty, security and sustainable development; and acknowledged the challenges and opportunities for sustainable development raised by globalisation and the role of partnerships with the private sector and civil society. Above all, the declaration commits signatory governments to implement the concrete steps for progress detailed in the Plan of Implementation. This provides a framework to help achieve the remaining goals from Rio and make further progress towards sustainable development.

Many of its specific targets re-state already agreed aims, but still, the plan was not easy to carve out. Many countries were aware of the limited progress that has been achieved since the Rio Summit and were reluctant to take on any targets, whether old or new, that might not be met. Instead, they focused on the more practical aspects of how they might achieve the existing commitments and ensure that they can implement future sustainable development policies.

The Johannesburg summit was intended to win an understanding of the need for balance among economic, social and environmental concerns and to reinvigorate the global commitment to sustainable development. By this definition, the negotiators at Johannesburg fulfilled their mandate.

The agreement on access to adequate sanitation is an entirely new target and an understandably difficult one because of the heavy financial resources it will require. Renewable energy was another particularly tough nut to crack. The EU and several other countries supported a proposal that 15% of world energy should be sourced from renewables by 2015 but the G77 oil-producing nations and the United States were against. Participants finally agreed to aim to "substantially increase" the global share of renewable energy sources, without setting a measure.

Other commitments include reducing biodiversity loss by 2010; restoring fisheries to their maximum sustainable yields by 2015; minimising the effect on human health and the environment of chemical production and use by 2020; starting to implement national strategies for sustainable development by 2005; and approving a US$3 billion replenishment of the Global Environment Facility (GEF). The latter featured an agreement to include combating desertification among the environmental projects that the GEF finances (in addition to projects on climate change, biodiversity, persistent organic pollutants, international waters and protection of the ozone layer).

The final litmus test of any international agreement, however, is the actual concrete actions put in place to carry it out. One key channel for achieving the goals laid out at Johannesburg is the Type II Partnerships – international, voluntary agreements for specific concrete initiatives. Such partnerships can include national, state and local governments, NGOs, the private sector and civil society. The OECD has agreed to actively participate in six partnerships – ranging from a partnership for a Globally Harmonised System for Chemicals Classification to one on Children's Environmental Health Indicators and one on a European Water Initiative.

A number of countries also took advantage of the Johannesburg summit to announce ratification of various multilateral environmental or other sustainable development-related agreements. Russia, China, India and others agreed to ratify the Kyoto Protocol on climate change, and once these commitments are met, the Kyoto Protocol will enter into force. Canada also announced its intention to put a vote on ratification to parliament before the end of the year.

So, the summit was anything but a complete failure. In fact, even the dissatisfied would admit that it was an opportunity for more than 40,000 people from all areas of society, including over 100 heads of state and government, 50 chief executive officers and representatives of more than 500 businesses, 400 trade union representatives and thousands of representatives of NGOs and civil society, to exchange ideas and information on achieving sustainable development, and to strengthen networks among them.

OECD leadership

So what can the OECD and its member countries contribute to this mammoth effort? Leadership is one thing. They can do this by increasing the coherence and integration of their own policies, and taking the necessary steps to overcome obstacles to policy reform. This includes integrating sustainable development concerns into the work of all ministries and ensuring that existing policies do not work against each other. For example, OECD countries are the largest donors of overseas development assistance (ODA), but at the same time protect and subsidise their own national industries, often at the expense of developing country would-be competitors. OECD country support to domestic production – particularly in agriculture, fisheries and energy – amounts to roughly six to seven times the amount of ODA provided to developing countries. Not only do many of these subsidies lead to economic distortions and environmental damage in OECD countries, but together with other barriers to trade they represent a loss of an estimated US$43 billion a year in exports for developing countries.

The OECD is working to identify and establish more coherent policies for sustainable development, and to overcome some of the obstacles – such as the fear of a loss of competitiveness – which block policy reform. But policy prescriptions are not enough. Success boils down to a question of will! For that we depend on political leadership. Here too the OECD plays an important role, helping to reinforce political determination by monitoring country progress towards sustainable development.

The OECD's highly regarded country surveys help to foster good governance by ensuring accountability in government policies and a sharing of best practices. Soon each OECD economic survey will include a section assessing the country's sustainable development performance, supplementing the already well-established environmental performance reviews of the OECD. A small step, perhaps, though a giant one if it improves our response to the challenges we face. ■

Fisheries accord: a fair catch

One of the first deals struck in Johannesburg during the World Summit on Sustainable Development was an agreement to do something about the precarious state of the world's fisheries and oceans. Hailed by negotiators as an important step toward saving fisheries resources from depletion, the agreement has nonetheless been heavily criticised, particularly by the non-governmental community.

On a general level, the WSSD Plan of Implementation provides several action points that the international or national communities can undertake, for example, signing up to the many international agreements and instruments that deal with fisheries, (e.g. UN convention on the law of the sea, UNCLOS). Nothing new, many will say, but at least it provides an improved political impetus and recognition of what is a serious and growing problem.

Perhaps the most important political commitment is that countries have signed up to restore fish stocks to sustainable levels by 2015. Some would say this is already too late. Yet change is needed that will not seriously upset the social and economic fabric of those coastal communities that depend on their fisheries.

The tools to help us solve the fishing crisis are there. Several road maps exist on possible ways to implement an effective transition to responsible and sustainable fisheries, including the important accompanying social policies. As usual, however, what is missing is not an understanding of the costs and benefits but rather the political courage to get things done. And in this regard, the outcome of the WSSD has given international organisations and the NGO community a crucial role to play in the next 10-15 years: to hold governments to the promises they made at Johannesburg.

Of the many suggested WSSD fisheries actions one stands out: namely, the elimination of subsidies that contribute to over-capacity. Over-capacity is the root of all evil in fisheries; as excess capital and manpower are tied up in fishing activities, more pressure on the resource may result and, concurrently, despite subsidies, fishing incomes will actually fall. In other words, subsidies eventually end up keeping fishers at a lower level of income than they could otherwise earn, while preventing policymakers and citizens from proper resource management. This link has to be cut if fishing communities are to expect a decent future and to be able to provide themselves with a sustainable living from the seas. The OECD's Committee for Fisheries will examine and advise governments on these aspects over the next two years and beyond. Once again, new policy measures are not needed; what are needed are the courage, conviction and commitment to reduce and finally eliminate the subsidies that generate over-capacity. The prize will be a return to a sustainable way of living for fishers and their communities.

- See OECD (2000), *Transition to Responsible Fisheries: Economic and Policy Implications*, Paris.
- Also Schmidt, Carl-Christian (2002), "Fish crisis: A problem of scale", in *OECD Observer* No. 233, August 2002.

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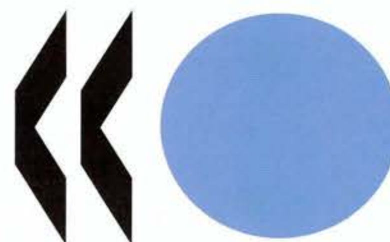

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Development Centre at 40

The OECD may be seen by some as a "rich countries' club", yet for four decades it has devoted considerable resources and effort to the global task of promoting development in non-OECD countries. It is home to the Development Assistance Committee (DAC), which is responsible for over 90% of global official development assistance (ODA) to developing countries, as well as home to the regionally focused Club du Sahel. And celebrating its 40th anniversary this year is the Development Centre, which has been an active forum for professional consultation, intellectual exchange and policy advice between the OECD and the emerging and developing economies of Africa, Asia and Latin America.

US President John Kennedy first proposed the creation of the Development Centre in 1961 in a speech to the Canadian Parliament: "...that the OECD establish a Development Centre, where citizens, officials, students and professional men of the Atlantic areas and the less developed countries can meet to study the problems of economic development."

Jorge Braga de Macedo, president of the Development Centre

The US is no longer a member, yet since its creation, the Development Centre has developed a rich "knowledge" network throughout the world, and has generated an impressive roster of cutting-edge research, exchange programmes, seminars and conferences. Recent studies include references like *The World Economy: A Millennial Perspective* and the *African Economic Outlook*, while its technical publications on financial stability, trade, education, income distribution, environment and health are in good demand. The Development Centre is marking its 40th anniversary with a publication of reflections and recommendations on development issues, called *Development is Back*.

One notable achievement is the Development Centre's work with the regional development banks – the Asian Development Bank and the African Development Bank in particular – to generate dialogue and frank exchange on global development challenges. And its informal seminars have included such speakers as former French prime minister Michel Rocard, Nigerian Head of State Olusegun Obasanjo and US economist Paul Krugman.

An impressive record, but the biggest goal of all has yet to be achieved: helping to make a serious dent in world poverty. The challenge continues. ■

New deputy secretary-general

Berglind Ásgeirsdóttir of Iceland joined the OECD as one of its four deputy secretaries-general on 2 September. The three other deputy secretaries-general are Richard Hecklinger of the United States, Seiichi Kondo of Japan and Herwig Schlögl of Germany. Ms Ásgeirsdóttir came from the Icelandic social affairs ministry, where as secretary-general she led work in sectors including employment, social services, housing, migration and refugee issues, gender equality and child welfare. Until 1999 she was secretary-general of the Nordic Council, a co-operation body based in Copenhagen and serving the parliaments of Denmark, Finland, Iceland, Norway and Sweden, where she implemented major reforms.

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Berglind Ásgeirsdóttir

Observer wins award

The *OECD Observer* has won a Highly Commended certificate in the annual ALPSP/Charlesworth awards from the Association of Learned and Professional Society Publishers. The *Observer* magazine, which is published by the OECD in partnership with FT Business, was singled out in the House/Membership Journals category for its good quality design and good contents. The outright winners in this category were *The Garden* and *Microbiology Today*. The awards were presented at a reception at the Institute of Engineers in London on 19 September.

ALPSP represents the community of not-for-profit publishers and those who work with them to disseminate academic and professional information.

- For more on the ALPSP awards: www.alpsp.org

Israel joins OECD on investment

Israel has signed up to the OECD Declaration on International Investment and Multinational Enterprises, which calls for foreign investors to be treated no less favourably than domestic enterprises. The declaration also promotes voluntary standards of business conduct through the OECD Guidelines for Multinational Enterprises. Adherence to the declaration will enable Israel to share experiences with the 30 OECD members and other non-OECD signatories, including Argentina, Brazil, Chile, Estonia, Lithuania and Slovenia.

Seiichi Kondo, OECD deputy secretary-general and Elie Barnavi, Israel's ambassador to France, at the signing ceremony for Israel's adherence to the OECD Declaration on International Investment and Multinational Enterprises

A recent OECD examination of Israel's foreign direct investment (FDI) policies encouraged the Israeli government to dismantle market access barriers and pursue privatisation of the banking sector and other major companies. It also recommended the simplification of administrative procedures.

In recent years, Israel has moved from an agrarian economy to a technologically advanced, service-based economy with per capita gross domestic product estimated at around 88% of the OECD average. FDI inflows had reached a cumulative total of US$21 billion at the end of 2001. ■

- OECD (2002), OECD Investment Policy Review – Israel, Paris, 2002.
- For more on the OECD Declaration on International Investment: www.oecd.org/daf/investment

– and SE Europe invests in reform

Eight Southeast European states have pledged to abide by a list of common principles and practices aimed at encouraging private investment, from transparent policies and removal of trade barriers to good corporate government and integrity in public administration. This represents an "important step on the path ... towards closer political and economic co-operation, as well as greater integration with the European Union and with the broader global economy," said OECD deputy secretary-general Richard Hecklinger at the signing of a declaration to this effect in Vienna on 18 July.

The declaration was developed under the auspices of the Stability Pact Investment Compact, jointly chaired by the OECD and Austria. The participating states have agreed to hold annual meetings at ministerial level to review progress in fulfilling their commitments. Moldova Deputy Premier Stefan Odagiu said the declaration sent "a powerful message to private businesses about the common effort to create favourable conditions for development in the region."

The signatories are Albania; Bosnia and Herzegovina; Bulgaria; Croatia; former Yugoslav republic of Macedonia; Moldova; Romania; federal republic of Yugoslavia: Serbia and Montenegro. n

- For more on the Southeast Europe Investment Compact: www.investmentcompact.org/
- FFFor more on OECD work with Southeast Europe: www.oecd.org/ccnm/regional/

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Calendar of forthcoming events 2002-03

Please note that many of the meetings mentioned are not open to the public or media and are listed as a guide only. All meetings are in Paris unless otherwise stated. For further information, consult the OECD website at www.oecd.org, under "Key upcoming events", which is updated weekly.

OCTOBER

2-3 **Regulatory Reform for South Eastern Europe**, seminar organised by the OECD Centre for Co-operation with Non-Members (CCNM) and the Public Management Service (PUMA). Thessaloniki, Greece.

6-9 **Biotechnology for Infectious Disease: Addressing the Global Needs**, workshop organised by the OECD Science, Technology and Industry (STI) and the Environment (ENV) Directorates, and sponsored by the Government of Portugal. Lisbon, Portugal.

9 **Privatisation and Corporate Governance of State-Owned Assets**, working group meeting organised by Directorate for Financial, Fiscal and Enterprise Affairs (DAF). Istanbul, Turkey.

9-11 **Financial Action Task Force on Money Laundering (FATF)**, first plenary meeting of FATF-XIV.

10-11 **Importance of ICT for Research and Science: Science Policies for Economies in Transition**, global research village conference organised by STI. Warsaw, Poland.

14-16 **Clean Russia 2002: International Exhibition and Conference on Waste Management** – problems and solutions of the 21st Century. Moscow, Russia.

16 **World Food Day**. Rome, Italy.

16-18 **Knowledge in a World of Risk: A Compass Towards New Prosperity**, World Knowledge Forum. Seoul, Korea.

17-18 **Regulatory Reform**, global forum on governance organised by CCNM/PUMA. Cheju Island, Korea.

23-1/11 **Climate Change**: Eighth Conference of the Parties to the United Nations Framework Convention. New Delhi, India.

23 **Development Centre Symposium**, organised to commemorate the creation of the OECD Development Centre in 1962.

27-30 **Small Business, Big Markets, One World: 29th International Small Business Congress**, hosted by the Royal Dutch Association of Small and Medium Sized Enterprises, MKB-Nederland. Amsterdam, The Netherlands.

NOVEMBER

3-5 **Fourth Asia Development Forum**, with a focus on placing trade on the development agenda, organised by the Asian Development Bank. Seoul, Republic of Korea.

4 **Quality Assurance and Proficiency Schemes for Molecular Genetic Testing**, experts meeting organised by STI.

7-8 **Environmentally Harmful Subsidies**, workshop organised by the Environment Directorate and the Directorate for Food, Agriculture and Fisheries (AGR).

11-12 **Attracting Foreign Direct Investment for Development**, global forum organised by CCNM/DAF. Shanghai, China.

12 **Improving the Prospects for Older People in the Labour Market**, meeting organised by the OECD Labour Management Programme.

18-19 **Biotechnology in the Agro-food Sector**, meeting organised by AGR/CCNM.

21 **OECD Economic Outlook No. 72** published.

21-22 **Promoting Knowledge-Based Economies in Asia**, workshop organised by the Institute for Policy Studies and STI. Singapore.

DECEMBER

5-6 **Soft Measures for Environmentally Sustainable Transport**, workshop organised by ENV. Berlin, Germany.

10-12 **Networking for Progress: The Keys for Successful Women Entrepreneurs**, conference organised by Dirigeantes in co-operation with the OECD, to be held at UNESCO, Paris.

11-12 **Managing for Development Results**, Development Partnerships forum organised by DAC.

18-19 **The Steel Industry**, high-level meeting organised by STI, to discuss the current steel market situation.

JANUARY 2003

14-17 **Policy Frameworks for the Digital Economy**, global forum organised by STI in preparation for the World Summit on the Information Society (December 2003). Honolulu, Hawaii, US.

MARCH

16-23 **World Water Forum**, third annual forum organised by the World Water Council. Kyoto, Japan.

APRIL

28-29 **OECD Forum 2003**.

29-30 **Annual OECD Council Meeting at Ministerial level**.

SEPTEMBER

10-14 **World Trade Organization**, 5th ministerial conference. Cancún, Mexico.

23-24 **IMF/World Bank annual meeting**. Dubai, United Arab Emirates.

Cleaner business

Fighting Hard-Core Cartels: Harm, Effective Sanctions and Leniency Programmes

"Our competitors are our friends, our customers are the enemy." Whether or not this sums up the cavalier attitude of cartels to business, they certainly appear to lack the service-oriented, open mentality today's society expects.

On conservative estimates, cartels cost consumers many billions of dollars each year. By fixing prices and rigging bids, they stifle innovation and reduce output. Indeed, hard-core cartels have been recognised as the most serious and harmful violations of competition law.

What then can we do to combat them?

Naturally, these cartels go to great lengths to remain undetected and unpunished. Without the help of an "insider", the veil of secrecy can be impossible to lift. In this book, the OECD identifies an increasingly successful "carrot and stick" approach – stiffer punishment, combined with greater incentives to defect and co-operate with the authorities.

Several countries already provide lenient treatment to those who confess and provide evidence – offering a smaller fine, shorter sentence, or complete amnesty. The first firm to break ranks should receive the highest reward, though a degree of leniency could also be offered to other co-operative firms, even after an investigation has begun. And this policy is proving successful – the US programme has led to the conviction of 30 defendants and the collection of well over US$1 billion in fines in the past two years.

On the flip side of the leniency coin, the sanctions "stick" must be severe enough to give effect to the "carrot". Fines serve a double function: they deter the formation of new cartels, while making defection more attractive. Though some countries have imposed large fines against organisations in cartel cases, many others have not. And few countries currently sanction individuals for cartel conduct – the risk of personal liability is a powerful deterrent.

Because the unlawful gain accruing to the cartel members from their activity is so great compared to the chances of detection, far heavier sanctions are needed. Some experts recommend two or three times the gain to the cartel.

There is a trend toward greater fines, but for now some competitors look set to remain the best of friends. ■

Does budgeting have a future?

OECD Journal on Budgeting Vol. 2, No. 2

Governments produce mountains of paper every year. But one document can reasonably claim to be more important than all the rest: the budget. Government accounts for over half of GDP in some OECD countries. The budget sends out essential economic signals about broad public policy directions and so has an influence on market behaviour. It decides whether taxes will rise or fall and establishes spending priorities through the allocation of funding. The budget affects the basic operational aspects of government ministries and agencies, including their efficiency and productivity. And it provides a framework for overall decision-making and accountability.

With all these important roles, it may come as a surprise to learn that the future of the budget as we know it is in question. "Does budgeting have a future?" is the provocative title of one report in the latest *OECD Journal on Budgeting*. The budget practices and policies of OECD countries have been undergoing significant change recently. Indeed, reform is "the Holy Grail of budget people, their unending quest for a better way to parcel out money and plan the work of government", leading to innovations like multi-year forecasts and generational accounting.

Perhaps the most striking development in budgeting is the recognition that politicians must make short-term decisions as well as investments intended to benefit several generations. OECD countries face a number of expenditure issues that can be seen as long-term in nature: the ageing population; the adequacy of infrastructure and other capital spending; and government loan and guarantee programmes.

Is budgeting simply changing focus? The trends and possibilities discerned in these articles suggest that a more radical transformation is taking place. In a globalised future, national governments may have bigger budgets but less effective influence over them. National budgets may become influenced by international rules and requirements which prescribe how they manage their finances and what they spend money on, as well as by local or regional governments which will lay claim to much of the nation's tax revenue. Clearly, the future of budgeting will be determined by what government becomes, assuming it too has a future.

The *OECD Journal on Budgeting* draws on the recent work of the OECD Working Party of Senior Budget Officials, and includes special contributions from finance ministries. ■

Silicon sustenance

Technology and Poverty Reduction in Asia and the Pacific

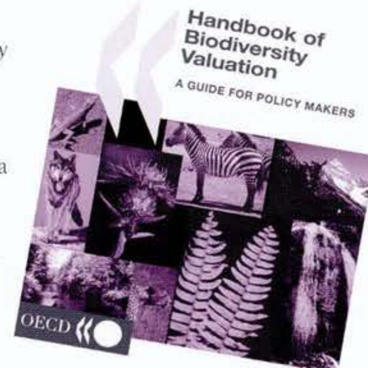
Can technology help to reduce hunger and eventually poverty, and if so, under what conditions? When Zimbabwe President Robert Mugabe refused to accept 20,000 tonnes of maize from the US to feed his starving people, the world collectively gasped. The problem, of course, was that it was genetically modified. This presented a number of sticky issues having to do not only with possible health and environmental effects, but with long-term market independence and possible effects on trade.

As *Technology and Poverty Reduction in Asia and the Pacific* points out, 40 years ago the Green Revolution promised to abolish hunger by increasing crop yields through a set of "miracle seeds". The use of better fertilisers, potent pesticides, modern irrigation and high-yield grain seeds did have a dramatic effect on agriculture, reducing malnutrition in much of Asia and Latin America as well as parts of Africa, despite a trebling of the population. Cereal production in Asia has doubled over the past 30 years, and calorie availability per person increased by over 20%, while real food prices have fallen by 50%.

Yet some argue that most of the benefits of higher production go to the employers, not the labourers. Traditional farming methods have been lost, the environment compromised, and crop yield has stabilised. This book, a collection of presentations from a Development Centre seminar, assesses the lessons learned from the Green Revolution and looks at the promises held out by the modern "Gene Revolution". It goes on to question the harmful effects on the poor of over-protective intellectual property rights and examines the current state of information technology in Asia, and what role it can play in reducing poverty.

The mere provision of technology is not enough. Bangalore in India is a kind of Silicon Valley, claiming to have more engineering colleges than any other city in the world. Yet, the region suffers more poverty than many other regions and its literacy rate is not much higher than the Indian average of 65%. Many graduates may well emigrate to lucrative positions at NASA or Microsoft, but the city's impressive focus on IT excellence is not yet combating poverty. ■

Biodiversity: Priceless, but what's it worth?



Handbook of Biodiversity Valuation: A Guide for Policy Makers

Biodiversity conservation is often hard to implement as a policy priority simply because there are measurement and valuation problems – it defies easy description and quantification and cannot easily be built into, say, measurements of GDP. Increasing development pressures have led to an unprecedented rate of biodiversity loss, yet what cannot be quantified is all too easy to disregard.

The absence of an economic value for biodiversity has meant that many biological resources have failed to compete with the forces that are damaging them. This OECD handbook is concerned with the ways in which value can be attached to biodiversity and, in particular, with the procedures and results of applying economic values.

Economic valuation has a sound theoretical foundation that can help clarify the trade-offs implicit in public policy, and can assess the biodiversity impacts of, say, investments in road building or a new factory or housing development. It can help determine legal damages, set charges, taxes and fines, help limit or ban trade in endangered species, and so on.

Valuation is not an easy task. Studies take time and cost money, and the number of possible values necessary for a complete understanding of the total economic valuation of biodiversity makes the work rather complex. A controversial but important response to this problem is examined in the handbook. By a practice known as benefits transfer, results are "borrowed" from existing studies and used in new studies to estimate the economic value of a similar environmental change. For example, the known benefits of a forest in Indonesia might be used to estimate the unknown benefits of a forest in Malaysia. This facilitates "rapid appraisals" of biodiversity worth, but introduces a range of methodological challenges.

Economic approaches do not answer all the questions. Some people want priorities for conservation sorted out by a legislature and a political process, based on what is morally justified. But economic approaches should play a prominent role in any policy mix. After all, economic forces are often the reason why biodiversity is severely threatened in the first place. ■

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Rules for rule-makers

Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance

Good fences make good neighbours, but fences can only work if they are constantly monitored and maintained. In the past 20 years, OECD countries have started taking a good look at how their national and local governments make and manage rules and regulations, and this publication serves as both an overview and a guide.

Regulatory policies are aimed at continuously improving the quality of legislation to reflect the changing needs of the public. This includes weeding out antique "horse-and-cart" ordinances and creating new laws to address current environmental, labour and economic conditions, as well as meeting public expectations.

It is not easy to strike a balance. Many corporations fight for fewer controls, yet others welcome the guidance good regulatory frameworks provide. The recent collapses of Enron and WorldCom are blamed on inadequate regulation, and the public constantly demands hard and fast rules on areas like transport security and food safety.

Regulatory frameworks can substantially improve market performance, public sector effectiveness and citizens' satisfaction, through a mix of deregulation, re-regulation and better quality regulation. Tradable permits, for instance, have helped the US Environmental Protection Agency to achieve reductions in sulphur dioxide emissions as part of its acid rain programme. Denmark's Green Tax System taxes energy use, emissions and wastewater discharge, and in Korea, long-term low-interest loans are available to firms that establish facilities that prevent, treat or recycle pollutants.

The OECD established a set of 10 "best practices" in 1997. Called Regulatory Impact Analysis (RIA), these guidelines ensure that the right questions are asked when creating regulations, and are the basis of a series of country reviews of regulatory reform by the OECD. ■

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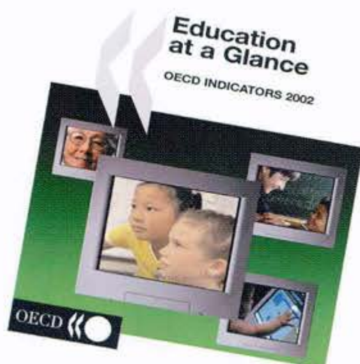


Education at a Glance: OECD Indicators 2002

In the world of education, students and teachers are on the move. More students attend universities and schools abroad, while teachers too have become more internationally mobile. In some ways, education has many of the characteristics of a large global business. This year's *Education at a Glance*, published in October, shows that within the OECD area, Australia, France, Germany, the UK and the US attract seven out of ten foreign students studying abroad. Greek, Japanese and Korean students are the largest sources of foreign students from OECD countries, while students from China and Southeast Asia make up the largest numbers of foreign students from non-OECD countries.

As the demand for learning grows in OECD countries, governments are having to establish policies and find resources for providing efficient, equitable and lifelong education. While virtually all young people in OECD countries can expect to go to school for 11 years, four out of ten go on to tertiary programmes leading to the equivalent of a bachelor's degree or higher. Furthermore, although one-third of OECD students drop out before they complete their first tertiary-level degree, for half of the OECD countries studied, more than 40% of the adult population enrolled in some form of continuing education and training within a 12-month period. With the exception of France, Germany and Turkey, participation in university-level education grew in OECD countries between 1995 and 2000, and in the majority of countries by more than 15%.

Education at a Glance shows that there are still gender differences in education. For the most part, women can expect to go to school half a year longer than men. Among older age groups, men have attained higher levels of schooling, but for younger people, this pattern is now being reversed in most countries as more women than men are completing their education.

A new component of *Education at a Glance* compares student performance across countries, shifting the focus from education inputs to outcomes. Drawing on the results of the OECD-PISA study, these comparisons show a wide disparity across the many countries surveyed in performances of 15-year-old school pupils in reading and scientific and mathematical literacy. Many of the results will serve as an eye-opener for educators. *Education at a Glance* will make it easier to shape educational methods to student needs and provides an opportunity for cross-border comparison of teaching and educational systems. It is now more than ever a valuable reference for all stakeholders in education, wherever in the world they might be. ■

Chinese cultivation

China in the Global Economy: Agricultural Policies in China after WTO Accession

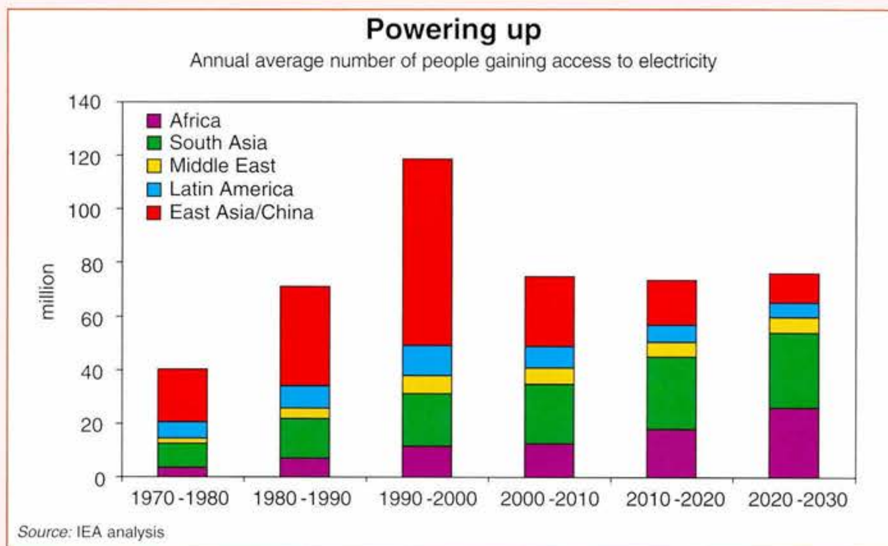
Two decades of agricultural reform have reduced poverty in rural China and incomes are still rising – last year, with an estimated upswing of 4.2%. But city dwellers are moving ahead much faster than their country cousins. In 1985, rural incomes were 54% of the level of their urban counterparts: today, they are less than one-third. The accession of China to the WTO and its integration into the global trading system will introduce further pressures on the farm market. The question is, how can China make the additional agricultural reforms needed to open its markets while protecting the livelihoods of its farmers? This report, a compilation of presentations from an OECD meeting in May 2002, provides at least some answers.

One of China's major messages to OECD countries is that China has made considerable concessions in joining the WTO, and it now expects OECD members to provide access to their markets. China's agro-food trade performance has deteriorated recently, and one of the reasons cited has been the technical barriers to trade and high levels of protection by OECD member countries.

China in the Global Economy: Agricultural Policies in China after WTO Accession provides an array of possible measures to help rural populations adapt to new conditions. These include fiscal reform to alleviate disproportionately high taxes and fees imposed on farmers by local authorities; a relaxation of labour migration restrictions; better access to education to provide the rural population with the skills needed to compete on urban labour markets; and greater access to social benefits.

Other suggestions include investment in rural infrastructure, such as roads and water, as well as giving land to more efficient farmers. Credit for rural enterprises and better poverty alleviation measures are also urged. ■

Energy drought



Source: IEA analysis

The fact that 1.6 billion people in the world have no electricity and 2.4 billion rely on primitive biomass (wood, agricultural residues, dung) for power may be shocking, but what is worse is that without radical new policies, the figures will be virtually the same 30 years from now. That is one message of the International Energy Agency's latest *World Energy Outlook* and "this is not a sustainable future," says IEA executive director Robert Priddle. Although access to electricity is spreading, it is not growing as fast as the world population, and on current trends 1.4 billion people will still be without electricity in 2030, the *World Energy Outlook* says. And because electricity is relatively expensive when it does arrive, people do not simply substitute it for biomass sources of energy. Many homes in developing countries use electricity only for light and still use wood and other biomass products for cooking and heating. As a result, on current trends the number of people reliant on biomass is expected to rise to 2.6 billion in the next 30 years, at significant cost to human health and the environment because of smoke pollution and reduction of natural biomass resources.

Because biomass will continue to dominate energy demand in developing countries in the foreseeable future, the development of more efficient biomass technologies is vital for alleviating poverty, creating employment and expanding rural markets, the *Energy Outlook* says. The IEA is a 26-member sister organisation of the OECD dealing with energy issues. ■

• IEA, *World Energy Outlook*, IEA, 2002

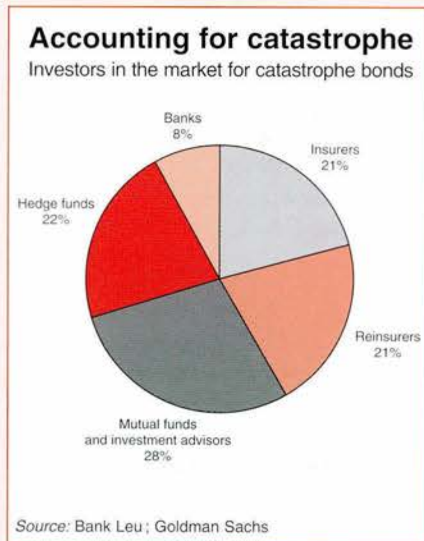
Insurance risks

Insurance is big business – gross premiums in OECD countries totalled US$2,510 billion in 2000, a 6.4% increase from a year earlier, almost half of it concentrated in the US with a market share of 45.6%. If you take out life insurance, the US share of the US$1,087.2 billion market is even larger, at 56.2%. The people and businesses paying these premiums are buying a guarantee that they will be cushioned against risk, whether it be loss of their most precious possessions in a burglary, death in an accident or the destruction of a factory building by fire, flood, or deliberate attack.

But how do insurers deal with their own risks, to ensure that they can meet an unexpectedly high number of claims due to events such as 11 September or the worst flooding in a century? One longstanding answer is reinsurance, where insurers borrow off-balance sheet capital to reduce pressure on their own risk-bearing capital.

But after a series of major catastrophes, a shortage of major funds can drive up the price of acquiring capital in the reinsurance market. This happened in the United States in the wake of Hurricane Andrew and the Northridge earthquake in the mid-1990s, and insurers turned to insurance-linked securities.

Demand for these stagnated in the late 1990s as reinsurance premiums fell, but market participants expect the events of 11 September to send demand for insurance-linked securities rising again, particularly "catastrophe bonds" covering predefined natural catastrophes such as an earthquake or hurricane. ■



Source: Bank Leu; Goldman Sachs

• OECD, 2002, *Financial Market Trends, Finance and Investment*, No. 82, Paris 2002
• OECD, 2002, *Insurance Statistics Yearbook 1993-2000*, Paris 2002

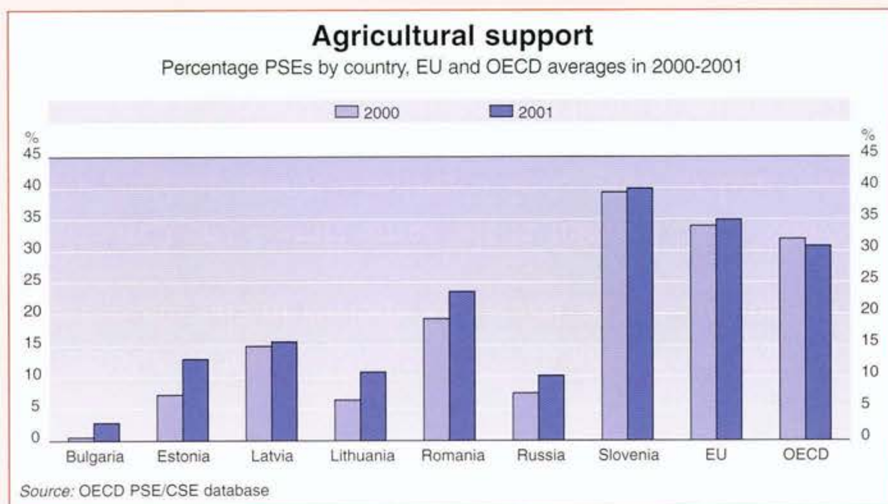
Farm support

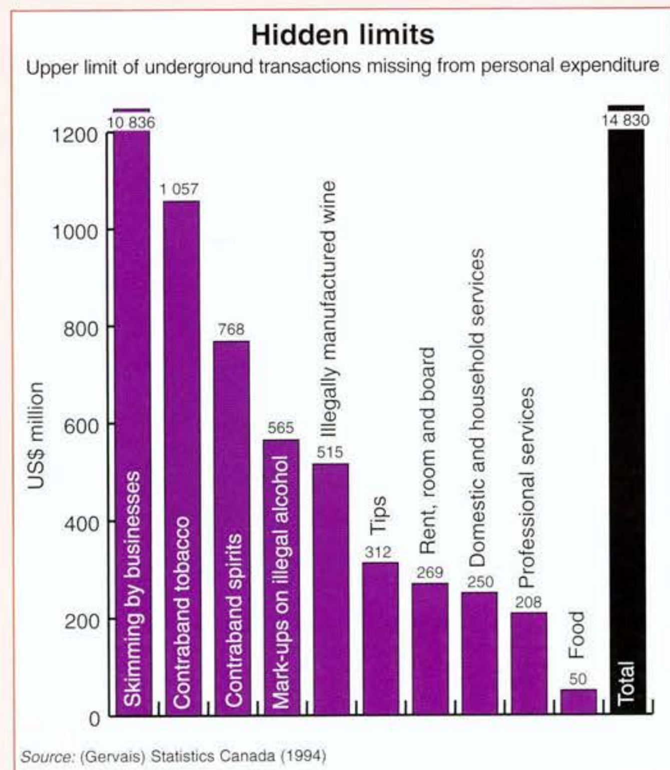
Transition economies are busy reforming their agricultural systems to join the EU, but in one area – agricultural support – most of them have already cut levels to below those of their EU neighbours, a new OECD study has found. And although Producer Support Estimates (PSEs) increased in all seven non-OECD transition economies in 2001, only Slovenia's support remained above the OECD and EU levels.

The increases in 2001 were marginal in most cases and PSE, which measures support as a percentage of total farm receipts, remains well below pre-reform levels, when it was significantly higher than the OECD average. This suggests that the transition was associated with a notable overall reduction of policy distortions in the agricultural sector, *Agricultural Policies in Transition Economies: Trends in Policies and Support* notes. Now Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovenia and Russia need to push ahead in areas such as land reform, market infrastructure and improved commercial production to be ready to meet future opportunities and challenges, for all of which they will need to attract investment, the report says.

One area where most transition countries remain above the OECD average is in the size of their agricultural populations. In Romania, for instance, more than 40% of the working population is in farming, compared with an OECD average of about 8%. ■

- OECD (2002), *Agricultural Policies in Transition Economies: Trends in Policies and Support*, Paris.





Valuable underground

Just how much is the underground economy worth? And if "underground" items are by definition undeclared, whether sales of smuggled cigarettes or payment for casual work, how can governments hope to measure it? This is important, because policymakers rely on national accounts and GDP figures to take decisions, and if the figures are inaccurate the policy responses are likely to be off-centre too.

But there are in fact tried and tested ways to limit the unknown. One is to compare figures for the same activity from the supply and demand side. Take the construction industry, often cited as a hive of undeclared activity.

Comparing households' declaration of the time and money spent on household repairs and improvements with activity declared by workers in this field helped Canadian experts arrive at an idea of how much activity was being hidden. Comparing how many cigarettes are officially sold with the number people saying they smoke can provide some idea of contraband tobacco activity.

Methods vary from country to country, as systems and likely areas of underground activity differ, but such tactics can help put a value on activities that will not otherwise find their way into the account books, or at least set upper and lower limits for likely discrepancies, says *Measuring the Non-Observed Economy: A Handbook*. ■

Indicators

MEMBERS	Gross Domestic Product			Leading Indicator			Consumer Price Index		
	period	% change from previous		*period*	% change from previous		*period*	% change from previous	
		period	year		period	year		period	year
Australia	*Q1 02*	0.9	4.2	*Jul. 02*	-0.9	5.2	*Q2 02*	0.7	2.8
Austria	*Q1 02*	0.5	-0.2	*Jul. 02*	-0.5	1.9	*Jul. 02*	-0.1	1.6
Belgium	*Q1 02*	0.4	-0.3	*Jul. 02*	0.2	5.4	*Aug. 02*	0.0	1.3
Canada	*Q2 02*	1.1	3.2	*Jul. 02*	-0.3	8.9	*Jul. 02*	0.5	2.1
Czech Republic	*Q1 02*	..	2.5		..	..	*Jul. 02*	0.5	0.7
Denmark	*Q2 02*	1.1	1.9	*Jul. 02*	0.1	8.7	*Jul. 02*	-0.3	2.2
Finland	*Q1 02*	-0.8	-1.9	*Jan. 02*	-0.5	0.8	*Jul. 02*	-0.1	1.7
France	*Q2 02*	0.5	1.0	*Jul. 02*	-1.4	-1.1	*Jul. 02*	0.0	1.6
Germany	*Q2 02*	0.3	0.1	*Jul. 02*	-0.1	1.2	*Jul. 02*	0.2	1.0
Greece	*2000*	..	4.3	*Jun. 02*	0.4	3.5	*Jul. 02*	-1.7	3.3
Hungary	*2000*	..	5.2		..	..	*Jul. 02*	-0.1	4.6
Iceland	*2001*	..	3.0		..	..	*Jul. 02*	0.1	4.1
Ireland	*2001*	..	5.9	*Jun. 02*	-8.1	-5.3	*Jul. 02*	-0.3	4.2
Italy	*Q1 02*	0.2	0.1	*Jul. 02*	-1.4	-0.1	*Aug. 02*	0.1	2.3
Japan	*Q2 02*	0.5	-0.9	*Jul. 02*	0.6	3.9	*Jul. 02*	-0.4	-0.8
Korea	*Q1 02*	1.8	5.0		..	..	*Jul. 02*	-0.3	2.1
Luxembourg	*2001*	..	3.5	*Jul. 02*	0.1	5.8	*Jul. 02*	-0.7	2.0
Mexico	*Q2 02*	0.6	0.4	*Jul. 02*	-1.6	2.8	*Jun. 02*	0.5	4.9
Netherlands	*Q2 02*	0.1	0.1	*Jul. 02*	1.1	3.4	*Jul. 02*	0.2	3.5
New Zealand	*Q1 02*	1.4	4.7		..	..	*Q2 02*	1.0	2.8
Norway	*Q4 01*	0.2	1.8	*Jul. 02*	-0.3	0.8	*Jul. 02*	-0.2	1.6
Poland	*2000*	..	4.0		..	..	*Jul. 02*	-0.5	1.2
Portugal	*Q1 02*	0.3	1.4	*Jul. 02*	-1.5	4.0	*Jul. 02*	0.2	3.4
Slovak Republic	*Q1 02*	..	3.9		..	..	*Jul. 02*	-0.3	2.0
Spain	*Q2 02*	0.4	2.0	*Jul. 02*	2.1	5.5	*Jul. 02*	-0.7	2.2
Sweden	*Q2 02*	0.6	1.6	*Jul. 02*	0.2	3.8	*Jul. 02*	-0.3	2.0
Switzerland	*Q1 02*	0.2	0.2	*Jul. 02*	0.1	0.9	*Aug. 02*	0.0	0.5
Turkey	*Q1 02*	..	2.3		..	..	*Aug. 02*	2.2	40.2
United Kingdom	*Q1 02*	0.1	1.1	*Jul. 02*	0.1	4.0	*Jul. 02*	-0.2	1.5
United States	*Q2 02*	0.3	2.1	*Jul. 02*	-0.6	1.4	*Jul. 02*	0.1	1.5
Euro area	*Q1 02*	0.3	0.3	*Jul. 02*	-0.4	1.3	*Jul. 02*	-0.1	2.0

NON-MEMBERS	Gross Domestic Product			Retail sales			Consumer Price Index		
Brazil		..	..		..	..	*Jul. 02*	1.2	7.5
Bulgaria	*Q1 02*	4.0	7.5	*Jun. 02*	0.8	1.2	*Jul. 02*	0.1	5.5
China		..	..		..	..		..	..
Estonia	*Q1 02*	0.1	3.1	*May 02*	1.4	16.3	*Jul. 02*	-0.3	3.1
Indonesia	*Q3 01*	-0.9	3.6		..	..	*Jun. 02*	0.4	11.5
Latvia	*Q1 02*	-0.6	3.7	*May 02*	2.7	16.2	*Jul. 02*	-0.4	1.0
Lithuania	*Q1 02*	0.2	4.0	*Jun. 02*	-1.4	6.6	*Jul. 02*	-0.2	0.1
Romania	*2000*	..	1.6		..	..	*Apr. 02*	2.0	27.1
Russian Federation	*2000*	..	8.4	*Jul. 01*	5.3	17.2	*Jun. 02*	0.5	14.9
Slovenia	*Q1 02*	1.6	3.7		..	..	*Jun. 02*	-0.2	6.8
South Africa	*Q1 02*	0.8	2.1	*May 02*	3.3	8.2	*Jul. 02*	1.5	10.6
Ukraine		..	..	*Feb. 02*	-3.5	16.8	*Mar. 02*	-0.7	2.2

Definitions & notes

Gross Domestic Product: Volume series; seasonally adjusted except for Czech Republic, Slovak Republic, Poland and Turkey. Data for the Euro area supplied by Eurostat.

Leading Indicators: A composite indicator based on other indicators of economic activity (qualitative opinions on production or employment, housing permits, financial or monetary series,etc.), which signals cyclical movements in industrial production from six to nine months in advance.

Consumer Price Index: Measures changes in average retail prices of a fixed basket of goods and services. HICP for Euro area.

Retail Sales: Volume series, seasonally adjusted.

	Current Balance			Unemployment Rate			Interest Rate		
	period	current period	same period last year	period	current period	same period last year	period	current period	same period last year
MEMBERS									
Australia	Q2 02	-4.12	-1.75	Jul. 02	6.2	6.9	Jul. 02	4.98	5.04
Austria	Q1 02	0.45	-1.21	Jul. 02	4.1	3.6		..	..
Belgium	Q4 01	2.31	2.32	Jul. 02	6.9	6.5		..	..
Canada	Q2 02	3.16	5.31	Jul. 02	7.6	7.1	Aug. 02	2.93	4.06
Czech Republic	Q2 02	-1.00	-0.75	Q1 02	7.6	8.3	Aug. 02	3.06	5.57
Denmark	Q2 02	0.84	0.67	Jul. 02	4.3	4.3	Jul. 02	3.59	4.85
Finland	Jun. 02	0.83	0.54	Jul. 02	9.3	9.1		..	..
France	Jun. 02	4.74	2.57	Jul. 02	8.9	8.5		..	..
Germany	Q2 02	8.28	-5.77	Jul. 02	8.3	7.7		..	..
Greece	Mar. 02	-0.53	-1.11		..	..		..	..
Hungary	May 02	-0.33	-0.15	Q1 02	5.8	5.9	May 02	8.49	11.10
Iceland	Q1 02	0.00	-0.20	May 02	2.2	1.4	May 02	8.70	11.12
Ireland	Q1 02	-0.18	-0.78	Jul. 02	4.5	3.8		..	..
Italy	Mar. 02	-1.14	0.26	Apr. 02	9.0	9.5	.. ..		
Japan	Jun 02	11.16	4.93	Jul. 02	5.4	5.0	Aug. 02	0.03	0.05
Korea	Apr. 02	0.63	1.04	Jul. 02	3.0	3.7	Jun 02	4.90	5.70
Luxembourg	Q1 02	-4.13	-4.83	Jul. 02	2.4	2.0		..	..
Mexico	Q2 02	-3.34	-4.29	Jul. 02	2.9	2.5	Aug. 02	7.07	8.54
Netherlands	Q2 02	0.35	0.14	Jun. 02	2.8	2.4		..	..
New Zealand	Q1 02	-0.20	-0.47	Q2 02	5.1	5.3	Jul. 02	6.00	5.79
Norway	Q2 02	7.27	6.54	Q1 02	3.9	3.5	Jul. 02	7.25	7.37
Poland	Jul. 02	-0.21	-0.41	Jul. 02	17.7	16.3	Jul. 02	8.53	14.77
Portugal	Q2 02	-2.52	-2.77	Jul. 02	4.5	4.1		..	..
Slovak Republic	Q1 02	-0.36	-0.35	Q1 02	19.4	19.7	May 02	8.80	9.30
Spain	May 02	-0.85	-0.97	Jul. 02	11.3	10.6		..	..
Sweden	Jun. 02	0.41	0.58	Jul. 02	4.9	4.7	Aug. 02	4.19	4.28
Switzerland	Q1 02	6.56	4.80	Jul. 02	2.8	1.8	Jul. 02	0.71	3.14
Turkey	Q1 02	-0.05	-0.20	Q2 02	9.6	6.9	Aug. 02	46.16	62.54
United Kingdom	Q1 02	-7.83	-6.27	May 02	5.1	5.0	Jul. 02	3.99	5.19
United States	Q1 02	-112.49	-107.72	Jul. 02	5.9	4.6	Aug. 02	1.73	3.48
Euro area	Jun. 02	1.34	-3.84	Jul. 02	8.3	8.0	Jul. 02	3.41	4.47
NON-MEMBERS									
Brazil	Jul. 02	-0.50	-2.04		..	..		..	..
Bulgaria	Jun. 02	0.09	0.00		..	..	Aug. 02	3.75	4.75
China	2001	17.41	20.52		..	..		..	..
Estonia	Jun. 02	-0.03	0.01	Jul. 02	5.8	6.4	Jul. 02	5.14	9.25
Indonesia	Q4 01	0.56	2.50		..	..	Jun. 02	16.24	14.92
Latvia	Jun. 02	-0.08	-0.03	Jul. 02	8.1	7.8	Jul. 02	7.70	11.80
Lithuania	Jun. 02	-0.08	-0.01	Jul. 02	11.2	12.7	Jul. 02	6.69	9.81
Romania	Mar. 02	-0.11	-0.07	Apr. 02	10.6	9.4	Mar. 02	33.40	49.90
Russian Federation	Q1 02	7.17	11.56	Dec. 01	1.6	1.4	Jun. 02	12.30	9.00
Slovenia	May 02	0.01	-0.05	Dec. 01	11.6	11.8	Jun. 02	9.39	11.40
South Africa	Q1 02	1.18	1.04		..	..	Aug. 02	11.73	9.37
Ukraine	Q3 01	0.39	0.90	Nov. 01	4.7	5.2	Apr. 02	27.10	33.00

Current balance: Billion US dollars; seasonally adjusted except for Greece, Ireland, and listed non-member countries. Data for Poland are on a cash basis.

Unemployment Rate: Per cent of civilian labour force — standardised unemployment rate; national definitions for Iceland, Korea, Mexico, Poland, Switzerland and Turkey; seasonally adjusted apart from the Slovak Republic and Turkey.

Interest Rate: Three months, except for Turkey (overnight interbank rate). Euro area rate is applicable for the 12 Euro area countries. * Refer to Euro area.
Source: Main Economic Indicators, September 2002; Quarterly National Accounts database.

Social security tax

Social security contributions accounted for about a quarter of tax revenue in OECD countries in 2000, unchanged from the 1995 level, but wide differences remain between countries because of differing definitions and practices, the latest edition of *Revenue Statistics* shows. Denmark takes 4.6% of its taxes in the form of social security contributions, the equivalent of 2.2% of GDP, and at the other end of the scale the Czech Republic relies on social security for 43.8% of its tax revenue, or 17.3% of GDP. European countries generally consider that most public programmes offering income protection are a form of insurance to be financed by social security contributions, and their social safety nets are well-developed, so they are mostly in the upper end of the spending scale. English-speaking countries (and Korea) finance a much greater part of their social benefits from general government revenues – in fact Australia and New Zealand do not levy social security contributions at all. And in general the ratio of social security contributions to GDP is lower in OECD countries with a relatively low GDP, except for the Czech Republic, Hungary and the Slovak Republic. The share-out in contributions between employers and employees also varies widely, with a fifty-fifty split in Germany, Switzerland, the United States, Luxembourg and Japan, and elsewhere employers generally paying the lion's share, except in Denmark and the Netherlands where it is employees who pay most. ■

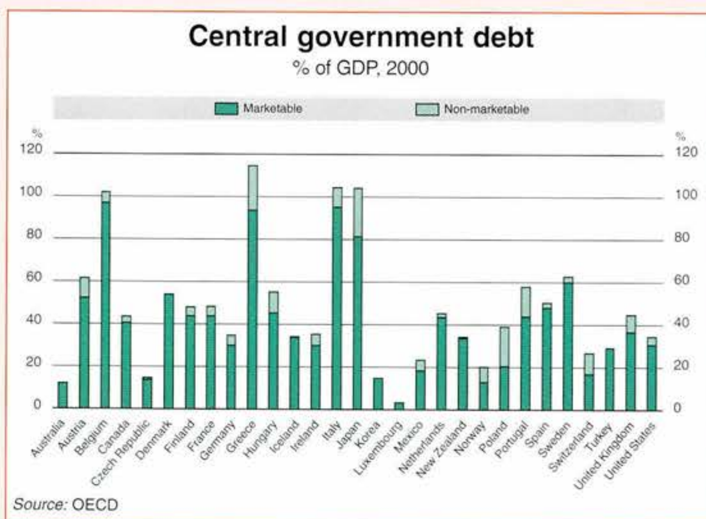
• OECD, 2002, *Revenue Statistics 1965-2001, 2002 Edition*, Paris 2002.

Social security contributions, 2000[a]

	% of GDP	% of total tax revenues
Czech Republic	17.3	43.8
France	16.4	36.1
Netherlands	16.1	38.9
Sweden	15.2	28.1
Austria	14.9	34.2
Germany	14.8	39.0
Slovak Republic	14.7	41.2
Belgium	14.1	30.9
Spain	12.4	35.1
Switzerland	12.0	33.6
Finland	12.0	25.6
Italy	11.9	28.5
Hungary	11.5	29.3
Greece	11.4	30.1
Luxembourg	10.7	25.6
Poland	10.0	29.4
Japan	9.9	36.5
Norway	9.0	22.5
Portugal	8.8	25.7
United States	6.9	23.3
United Kingdom	6.1	16.4
Turkey	5.6	16.9
Canada	5.1	14.3
Korea	4.4	16.7
Ireland	4.2	13.6
Mexico	3.0	16.4
Iceland	2.9	7.8
Denmark	2.2	4.6

a) The 28 countries included in this table are ranked by decreasing ratio of social security contributions to GDP. Two of the thirty OECD countries, i.e. Australia and New Zealand, are not included in the table, because they levy no social security contributions.

Managing debt



Source: OECD

Central government debt in OECD countries almost doubled between 1990 and 2000, to US$12,860 billion from US$7,180 billion a decade earlier as market-based financing of budget deficits continued to boost growth of the global sovereign bond markets. Some 84% of government borrowing requirements in the 1990s were met through marketable instruments, a new OECD study found. By the late 1990s, longer-term instruments accounted for the larger part of government debt, as debt managers sought to minimise re-financing as well as nominal risk, *Debt Management and Government Securities Markets in the 21st Century* shows. And liquid public debt markets proved to be key for the development of corporate debt markets, as the yield curve for government securities is important for correct pricing of corporate bonds. But while liquidity in public debt markets increased significantly and a yield curve of benchmark bonds was established, market liquidity as well as overall debt levels still differs considerably across countries. Belgium, Greece, Italy and Japan all have debt levels of more than 100% of GDP, but the non-marketable share is larger in Greece and Japan than in Belgium and Italy. ■

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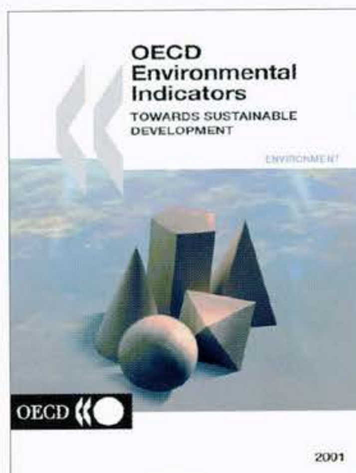

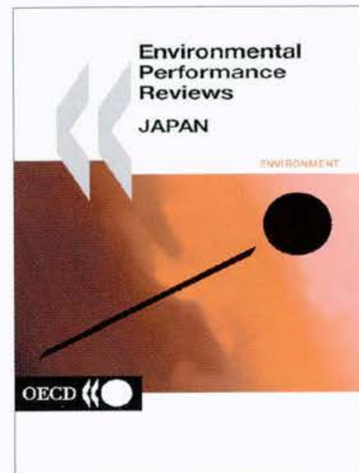

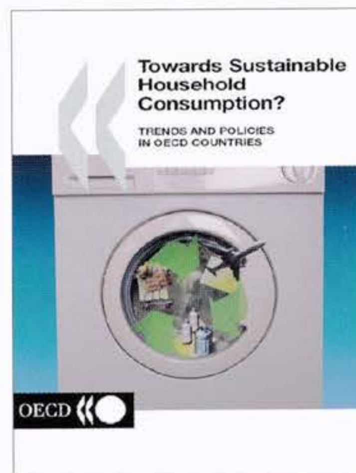

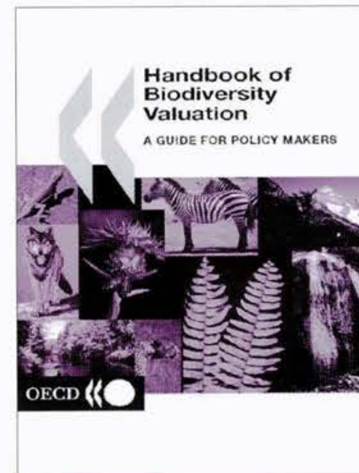

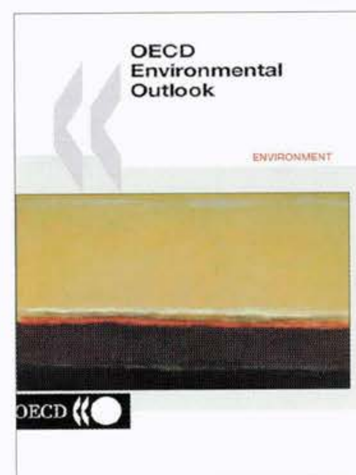

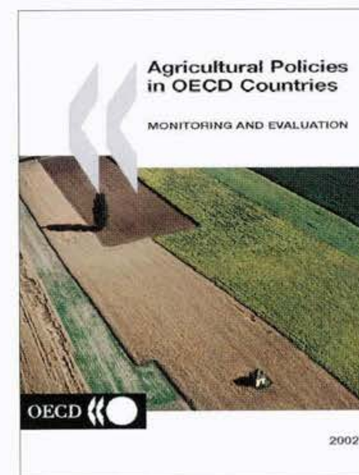

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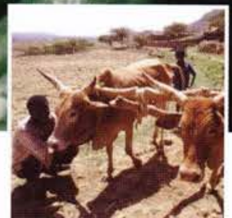
Invest in Africa's farmers for long term economic growth



If farming is the basis for rural livelihoods, should it not be the starting point for building a prosperous rural economy and the only sound base for building food security for the poor?

Start from where people are and build on what they have.

"My children have joined school. I have also started other business from the income I earn from my goats"
Mrs Kiros Demewoz , project beneficary, Tigray, Ethiopia

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